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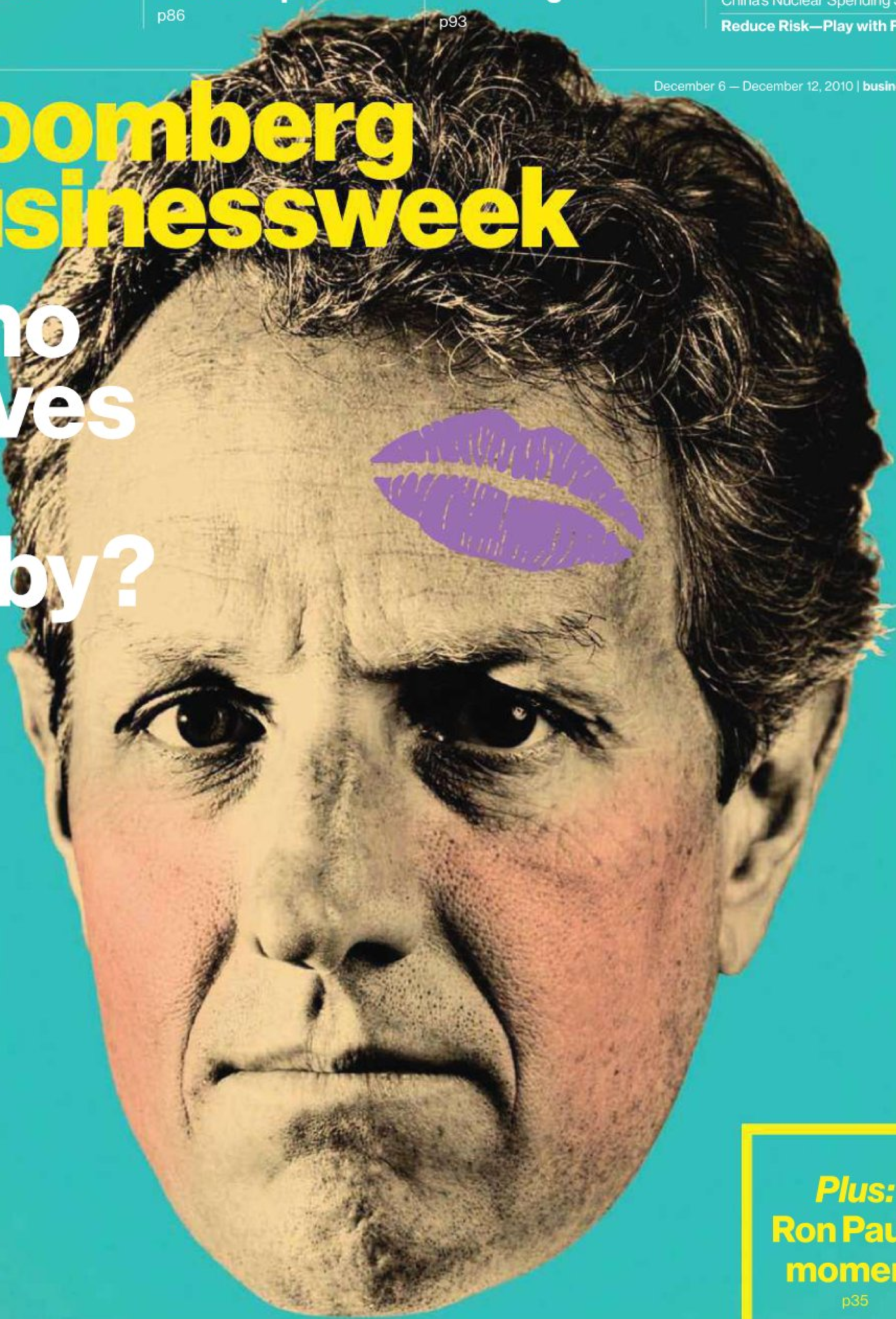
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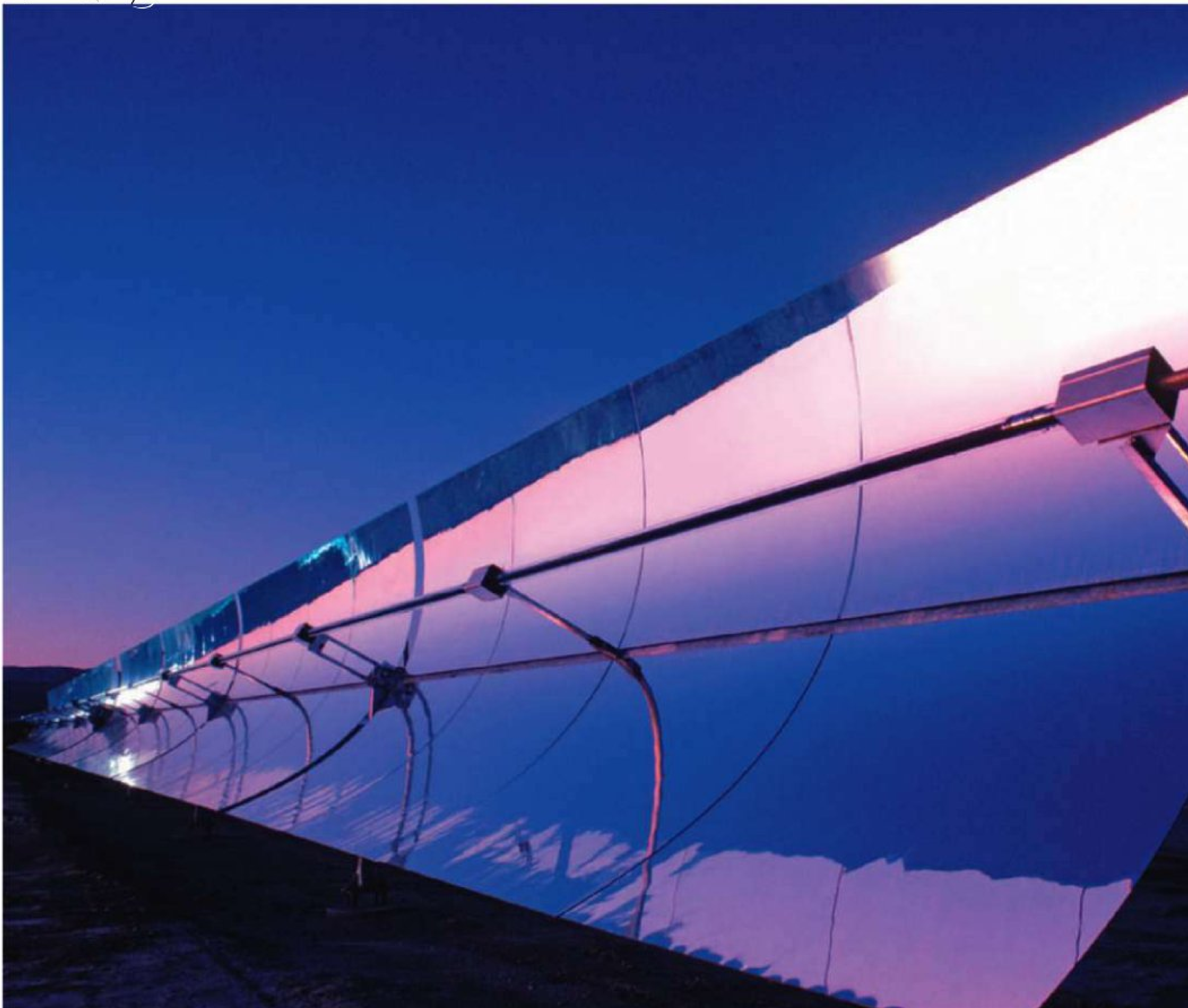
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Corrections & Clarifications

In "On the Dollar, Traders Back Bernanke" (Markets & Finance, Nov. 29), the U.S. Commodity Futures Trading Commission was incorrectly identified as the U.S. Commodity Futures Trading Assn.

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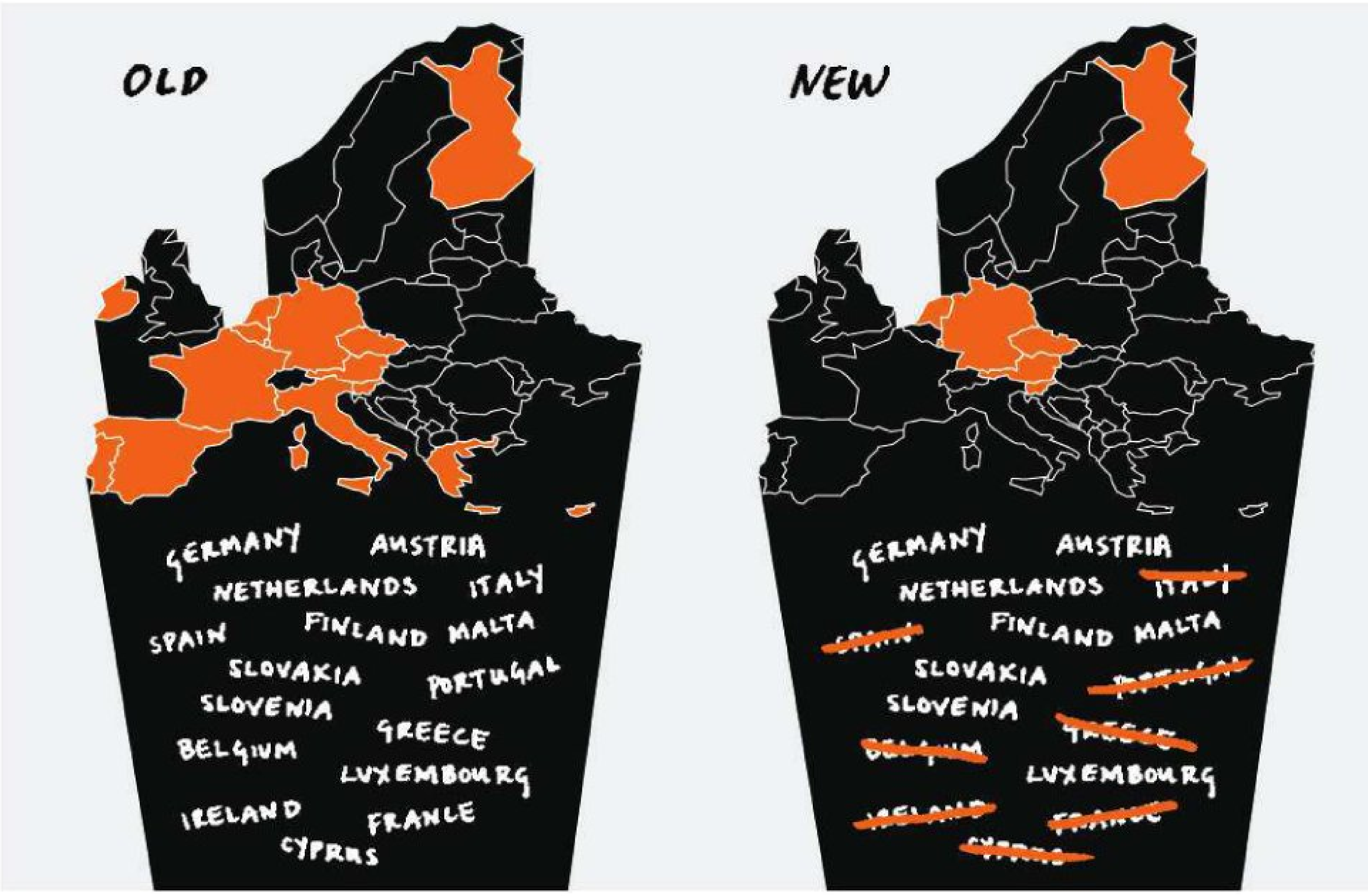
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Opening Remarks

A More Perfect Union?



The euro zone—born of cultural similarity—is threatened by its economic inequalities. It doesn't have to be. By Peter Coy

In December 1998 and January 1999, high-energy physicists in Russia created a superheavy element called ununquadium with a record 114 protons. It was an impressive technical achievement. Alas, ununquadium ("oon-oon-QUOD-ee-um") is too unstable to exist in nature. The force binding its nucleus together is overwhelmed by the force tearing it apart. The synthetic element has a half-life of just 2.6 seconds.

At the very moment that the physicists in Dubna, Russia, were birthing ununquadium, another group of scientists–dismal scientists–were smashing together the currencies of Western Europe to form a brand-new synthetic element known as the euro, which they proudly launched on Jan. 1, 1999. Less than a dozen years later, the euro is under serious strain. "European officials have squandered ... confidence, and like toothpaste coming out of a tube, it is difficult to put it back in," writes Marc Chandler, global head of currency strategy at Brown Brothers Harriman. Some agonizing questions are being openly asked. What will it take to restore monetary stability in Europe? Is the euro, like ununquadium, simply too massive for the natural world? If so, how might it blow apart–and how much damage might it do in the process?

What's so concerning to European policymakers is that the conflagration keeps jumping over their firebreaks. Sovereign borrowing costs kept rising after the announcement on Sunday, Nov. 28, of a tentative €85 billion emergency loan package for Ireland. It's not even clear that the Irish legislature will agree to take the money on the terms offered. "The plan should have been announced in Lourdes because, short of a miracle, it is doomed to failure," says Jack O'Connor, head of SIPTU, Ireland's biggest union.

Back in 1999, at the euro's launch, hopes were high that Europe would cleanse itself of its warring past as efficiently as it dispensed with historic currencies like the peseta, franc, guilder, and deutsche mark. Speakers harked back to Winston Churchill, Britain's wartime Prime Minister, who in 1948 said: "We hope to see a Europe where men of every country will think of being a European as of belonging to their native land, and ... wherever they go in this wide domain ... will truly feel, 'Here I am at home.'" If anything, the opposite is occurring. The euro coin has become a millstone to many, and forced togetherness is reviving prejudices between nations.

Sovereign debt crises aren't new. Greece was in default on foreign debt for 90 of the years between 1826 and 1964, according to economists Carmen Reinhart and Kenneth Rogoff. What makes

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Opening Remarks

It's been known for centuries that monetary unions are hard to hold together. The creation of the euro zone was—as Samuel Johnson said about second marriages—the triumph of hope over experience

this crisis a threat to the euro's solidity is that the common currency is impeding member nations' ability to get back on their feet. Ordinarily when a nation like Greece or Ireland loses competitiveness, it gets it back by allowing its currency to depreciate–its exports automatically become cheaper to foreign customers while imports become more expensive, which discourages consumers from buying so many of them. Iceland regained competitiveness when its krona abruptly lost half its value in 2008. Since the euro zone's weaker members can't depreciate, the only way for them to regain competitiveness is to cut pay and benefits. That's "a very much more painful way to achieve real devaluations," Martin Feldstein, the Harvard University economist and former chief economic adviser to President Ronald Reagan, wrote in a June article in *The Weekly Standard*. (Feldstein, not incidentally, was warning about the euro's drawbacks in 1999, when many other economists were all smiles.)

It's been known for years–centuries, really–that monetary unions are hard to hold together. World War I killed the Scandinavian and Latin monetary unions, the latter of which included France, Belgium, Italy, Switzerland, Greece, and Bulgaria. As theorized by Robert A. Mundell, the Nobel Prize-winning economist at Columbia University, a monetary union can't survive without something very close to political union, including free mobility of labor to nations where jobs are more available, flexible wages, a tax system that transfers funds from the winners to the losers, and strict rules preventing members from running up big budget deficits. Members must feel that burdens are fairly shared: Ireland has infuriated the Germans by keeping its corporate income tax rate at 12.5 percent (Germany's is 30 percent) even while appealing for help. The euro's backers optimistically believed that the very yoke of the common currency would bring about the behavior the euro's continued existence depended upon. The euro was–as the English essayist Samuel Johnson said about second marriages–the triumph of hope over experience.

The euro zone's crisis may yet galvanize political leaders to tighten the links between their nations. "We may see a much faster move towards a de facto fiscal union," says Gary Jenkins, head of fixed income at London-based Evolution Securities. The euro stopped falling on Dec. 1 on a hint from European Central Bank President Jean-Claude Trichet that the bank might support endangered countries by buying more of their bonds. A more dramatic though less likely gambit would be to raise funds with a new "blue bond," whose payments would be guaranteed by all euro zone members collectively. Euro nations understand that a breakup of the zone would have serious repercussions. "No one gains," Carl Weinberg, chief economist of High Frequency Economics in Valhalla, N.Y., wrote in a Nov. 29 e-mail. "Thousands of jobs in Germany's export sector would be lost" if a euro breakup resulted in a high-priced new deutsche mark, Weinberg wrote, while "the southern zone would lose access to the finances and the financial standing of their monetary link to the richer nations."

But as European credit markets go haywire, it's no longer possible to rule out a euro zone breakup of some kind. And it would be hard to stop at just Greece or just Ireland. "Once you've established the principle that a country can leave, you've planted the idea that others can leave," says Mark Cliffe, chief economist of ING, the Dutch financial giant. "Frankly, I can imagine just about anything happening here."

If the euro zone were to break up, it would make sense for member nations to regroup in more defensible configurations–ones more nearly resembling the optimal currency areas described by Columbia's Mundell. To stop the market terror before it engulfs all of the euro zone, the fiscally strongest nations should gather behind an impregnable "cordon sanitaire," argues Simon Johnson, the former chief economist of the International Monetary Fund, who is a professor at Massachusetts Institute of Technology and a Bloomberg News columnist. As Johnson sees it, those strong nations would trust each other enough to promise one another unlimited financial support if any of them ran into trouble, which would stop the bond market vigilantes cold. In that group he puts Germany, Austria, the Netherlands, Finland, Slovakia, Slovenia, Luxembourg, and tiny Malta.

The scary thing about Johnson's cordon sanitaire is that it would leave France, Italy, Spain, Belgium, Portugal, Ireland, Greece, and Cyprus on the outside, unshielded from market forces. At least a couple of the weaker shunned nations would be likely to default. In the long run, though, it could be a blessing for them to be spared from monetary and fiscal policies that just don't suit them and debts that are, frankly, unpayable. Like serial defaulter Argentina, they would still find it possible to borrow money, albeit at a higher rate. And with depreciated national currencies, they would be able to match their exports to their imports.

The biggest downside of such a scenario would be the death of the dream of a united Europe. It appears, though, that Europe still isn't ready for a full union. As in the nucleus of the elusive ununquadium atom, the forces of repulsion remain stronger than the forces of attraction. It might be wiser to acknowledge that reality than to sacrifice a generation of indebted Europeans to an impossible ideal. B

—*With Dara Doyle and Simon Kennedy*

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James White, Chief Executive Officer of Jamba Juice Co., left, speaks with Michael Landau, Founder of Drybar at a Drybar salon in Los Angeles, California, U.S.

Bloomberg the MENTOR

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Global Economics



A reactor under construction in east China's Zhejiang Province

TAN JIN/XINHUA/ZUMA PRESS

China Wants Nuclear Reactors—Fast

▶ An ambitious program aims to have 27 new nuclear power plants up and running by 2020

▶ "We look at this as a long-term opportunity... but there are no guarantees"

The ballroom of the Grand Hyatt on Beijing's East Chang An Avenue was packed. The occasion: the first-ever China International Nuclear Symposium, a gathering of China's top nuclear players and many of the world's nuclear power companies, including **Westinghouse**, **Areva,** and **Hitachi-GE.**

What brought the Chinese to the Hyatt on Nov. 24 and 25 was a hunger for the latest technology. What brought the foreigners was money: According to Michael Kruse, consultant on nuclear systems for Arthur D. Little, the Chinese are ready to spend $511 billion to build up to 245 reactors. "The market is being driven by the construction of new reactors, and it is no secret that most of those are right here in China," says Fletcher T. Newton, an executive vice-president of **Uranium One**, a mining company.

The global nuclear industry is willing to take big risks to get a piece of China's nuclear budget. The danger is that in landing those fat contracts—and sharing technology with Chinese partners—the industry will help build a formidable rival. Even though they lack the most advanced technology, the Chinese are rapidly becoming self-sufficient in reactor design and construction, according to the World Nuclear Assn. The industry has the backing of the deep-pocketed Chinese state, an ambitious plan to train an army of nuclear engineers, and the leverage that comes from being the biggest market around. "They are going to use a bunch of different [suppliers] with the goal of being a developer themselves," says Jeffrey Holzschuh, a Morgan Stanley vice-chairman.

Unlike the rest of the world, when it comes to building nuclear reactors in China, money is not an issue

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Westinghouse, for example, says it has handed over more than 75,000 technical documents to its Chinese customers as part of an agreement to license reactor technology. "We look at this as a long-term opportunity and partnership," says Jack Allen, Westinghouse Asia's president. "But there are no guarantees."

Just 13 nuclear plants operate in China today, and until recently the Chinese were building only one or two reactors a decade. Now they are building 25 facilities, accounting for close to half the reactors under construction worldwide (map). "This shows the rapid momentum of China's nuclear power development," says Zhang Shanming, president of **China Guangdong Nuclear Power Group**, the country's No. 2 builder and operator of reactors.

China's energy planners say they aim to have 40 reactors by 2020 and, by 2030, enough additional reactors to generate more power than all 104 reactors in the U.S., the leader in nuclear energy. Westinghouse, Areva, and other foreign companies will profit by licensing their reactor technology, consulting on safety and other issues, supplying components, and helping with construction. "Money is not an issue, which is different from the rest of the world. The Chinese have the capacity to deliver and they are deadly serious about achieving it," says Steve Kidd, director of strategy and research at the London-based World Nuclear Assn., the industry trade group.

President Hu Jintao wants nonfossil fuels to produce 15 percent of China's energy by 2020. Although the Chinese have spent plenty on wind turbines and solar panels, only a buildup of nuclear power can make that target reachable. "Developing clean, low-carbon energy is an international priority," says Zhao Chengkun, vice-president of the China Nuclear Energy Assn. "Nuclear is recognized as the only energy source that can be used on a mass scale to achieve this."

Foreign companies are already getting contracts. On Nov. 23, **Cameco**, the miner, agreed to supply 29 million pounds of uranium to Guangdong Nuclear through 2025. Thomas Mundy, president and chief executive officer of **Exelon Nuclear Partners**, whose parent company runs 17 nuclear reactors in the U.S., says he hopes to reach an agreement by mid-2011 to help the Chinese manage their reactors. Westinghouse designs are being used for four reactors now being built. Areva has sold two latest-generation reactors now under construction, as well as nuclear fuel. Areva Chief Executive Officer Anne Lauvergeon told the French Senate on Nov. 24 that she expected another deal on two more.

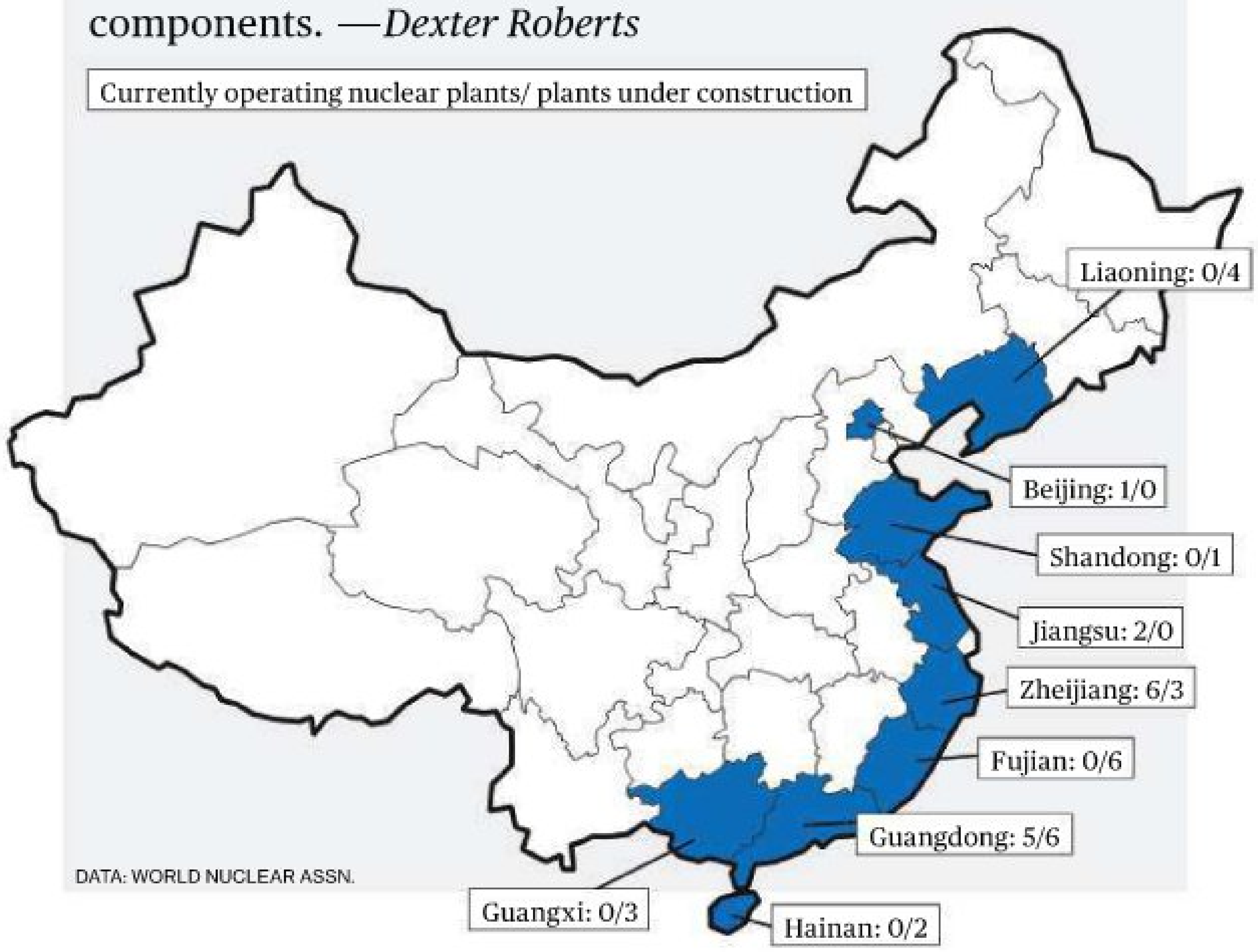
According to Lauvergeon and Allen, China is building reactors faster and at a lower cost than the rest of the world. State ownership of the industry guarantees capital and relatively quick approvals of new plants. Low-cost labor and experience in major infrastructure projects, whether power plants or subway systems, also help. As a result, building a Western-designed reactor in China costs about $4 billion, 40 percent less than one in Normandy, and can be completed in 46 months, vs. 71 months in France, according to Areva.

One challenge for the Chinese is locking in a supply of components, including reactor vessels (which protect the nuclear fission core), steam generators, and nozzles produced in large-size forges. Just a few companies make these parts, says Westinghouse's Allen. "You end up in a queue for these long-lead

Nuclear Power

Where China Is Building Its Reactors

Almost half the nuclear reactors under construction in the world today are in China. The Chinese are employing reactor designs from Russia, the U.S., France, and China itself. A key issue is whether foreign suppliers will be able to keep up with Chinese demand for critical and scarce components. —*Dexter Roberts*



DATA: WORLD NUCLEAR ASSN.

Quoted

"The media that he had drawn in to project himself as a no-nonsense reformer ... took its vengeance, portraying Sarkozy as a vulgar, insecure celebrity worshipper focused only on himself and his place in the limelight."
—U.S. Embassy description of French President Nicolas Sarkozy and the impact of his courtship and marriage to Carla Bruni, as revealed by WikiLeaks



FROM TOP: BRENDON O'HAGAN/BLOOMBERG; GERARD CERLES/AFP/GETTY IMAGES

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Qantas clears the air after the blowup page 26 ▶



specialized materials," he says. "That is a constraint on how fast you can build."

How long will it take for the Chinese to become tough competitors? Guangdong Nuclear says it would like to be selling its reactors abroad by 2013 (to date, China has supplied commercial reactor technology only to Pakistan). The Chinese ability to complete large civil engineering projects is already "very worrying" for Europe's companies, Lauvergeon told the French Senate on Nov. 24. Yet Areva, like every other Western company, still wants those China deals. *—Dexter Roberts and Stanley Reed with Francois DeBeaupuy, Rachel Layne, and Tara Patel*

The bottom line *China expects to spend $500 billion on as many as 245 reactors as part of a plan that could transform the global nuclear industry.*

Outsourcing

So Long, Bangalore; Now Manila's on the Line

▶ **In the call center business, the Philippines has overtaken India**

▶ **"These guys had a much later start, but they have caught up"**

For the past decade, Americans dialing customer service have stood a strong chance of being connected to someone in India. Now they're more likely to end up phoning the Philippines. Although the country got a slow start in outsourcing, strong government support, a plentiful supply of English-speaking college grads, and an effort by call center operators to diversify have helped the Philippines overtake India in call center revenues. "It's not that we are trying to take business away from India," says Oscar Sañez, chief executive officer of the Business Processing Association of the Philippines, an industry group. "We're just looking for our own place in the sun."

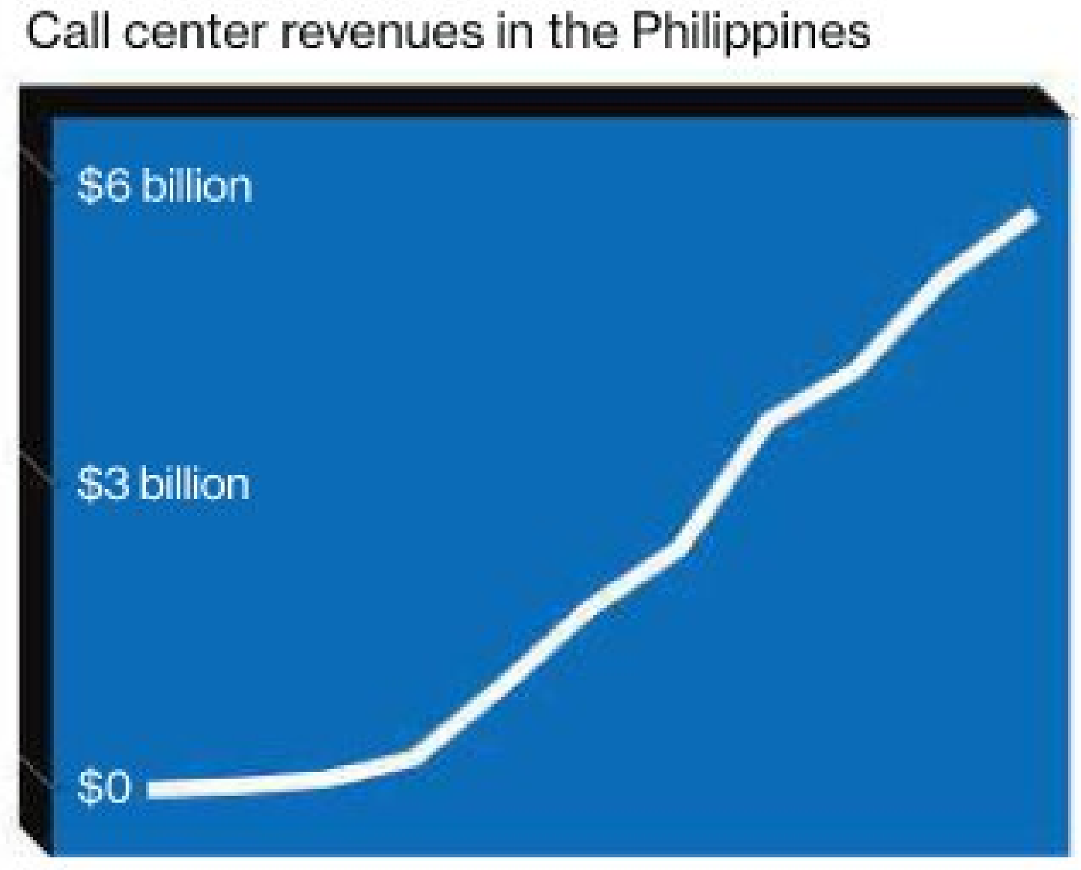
The Philippines this year will pocket $5.7 billion for call center work from the U.S., Europe, and Australia, vs. the $5.5 billion that India's call centers will take in, according to the Everest Group, an outsourcing advisory firm. Call center operators like the Philippines because English is taught in schools and Filipinos have a cultural affinity for the U.S., which ruled the country from 1898 to 1946. "Clearly, these guys had a much later start, but they have caught up," says Everest Group partner Nikhil Rajpal. India, though, continues to lead in overall outsourcing revenues: $70 billion, vs. $9 billion for the Philippines. The outsourcing industry now employs 530,000 people in the Philippines and makes up about 6 percent of gross domestic product.

A decade ago, millions of young Filipinos, especially English-speaking nurses and law students, had emigrated to the U.S., Hong Kong, and elsewhere. The billions of dollars they sent to their families every year represented the country's second-largest foreign exchange earner, after computer chips from **Texas Instruments** and a handful of other tech players. Frustrated government officials looked to India for inspiration. "India had become very famous for call centers, and we decided to learn from their example," says Celeste Ilagan, who spent the past decade working in government programs to encourage outsourcing and now heads communications for **SPi Global**, a call center operator owned by the Philippines' largest telecom company.

To better understand India's success, Filipino officials visited industry representatives in that country. The Filipino government streamlined the approval process for companies setting up call centers and changed its rules to allow individual buildings to be designated special economic zones. Such zones offer tax breaks, quick clearances for building permits, and an exemption from import duties on computers and telecom gear. And some 40,000 students have benefited from government-sponsored training to improve their English and communication skills.

Dialing for Dollars

Call center revenues in the Philippines



DATA: BPAP, EVEREST GROUP

Call centers are changing the rhythms of Filipino life. Malls, bars, cinemas, and cafés have popped up near buildings where young, nocturnal workers earn as much as 300,000 pesos ($6,850) a year in a country where annual per capita GDP in 2009 was about 83,000 pesos, Bloomberg data show. Weaned on radio stations that play U.S. Top 40 pop and hip-hop, teens seeking jobs in call centers can banter in English as naturally as their native Tagalog. "There used to be some doubts about letting young people work so late at night, but now this has become an industry that young people aspire to," says Thea Lu, a 30-year-old team leader with **24/7 Customer**.

A big part of the Philippines industry is run by companies that participated in India's outsourcing revolution and are now looking to expand abroad. A tax break for Indian outsourcing shops is set to expire in 2011, though the industry is lobbying hard against it. In Bangalore and Gurgaon, India's biggest outsourcing hubs, companies must rely on diesel generators to ensure electricity, run fleets of buses to ferry employees to and from work, and struggle with attrition that can reach 50 percent a year.

Those hassles, as well as a desire to diversify geographically, have spurred both Indians and Americans who operate call centers in India to shift work to the Philippines. Bangalore-based **Wipro** set up in the Philippine city of Cebu in 2007 and now has 2,000 workers in the country; by 2014 it expects to increase that to 8,000. And 24/7 Customer, a California company that started operations in India in 2000, opened a Philippines office in 2005. It now has 4,000 employees in the country, vs. 3,000 in India. "It's very sad that India could not keep up with its neighbors," says 24/7 cofounder Shanmugam Nagarajan.

As the Philippines government aims to double overall outsourcing revenues, to $18 billion by 2015, it faces big hurdles. While it's easy to hire new recruits who speak English, finding experienced managers is tougher; in an industry so young, few people have been around long enough to handle management or strategy jobs. "Where are we going to find the right kind of managers who can make our operations stand out?"

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asks Steve Barker, who heads Asian operations for **Sitel**, a Nashville-based company that has 10,000 workers and seven facilities in the Philippines.

Another obstacle is that the Philippines produces only about 10 percent as many engineers as India. Indian outsourcing shops have gone from answering phone calls to account management, tech support, and consulting gigs such as helping banks manage financial derivatives and improving retailers' supply chains. While it's fairly easy to handle customer phone calls, higher-level work requires the kind of specialized education that India provides the 400,000 engineers it graduates annually. "Ten years down the line the Philippines may be a hotter destination," says Sanjeev Bhatia, who oversees international operations for Wipro BPO. "But in IT and software, India really doesn't have any competition." —*Mehul Srivastava*

The bottom line *The Philippines has overtaken India in call centers, though it remains far behind in more sophisticated outsourcing services.*

Mideast Reform

After Abdullah, What Next for the Saudis?

- The monarch's recent surgery raises the succession issue
- "Succession is really a problem. We don't know what is going to happen"

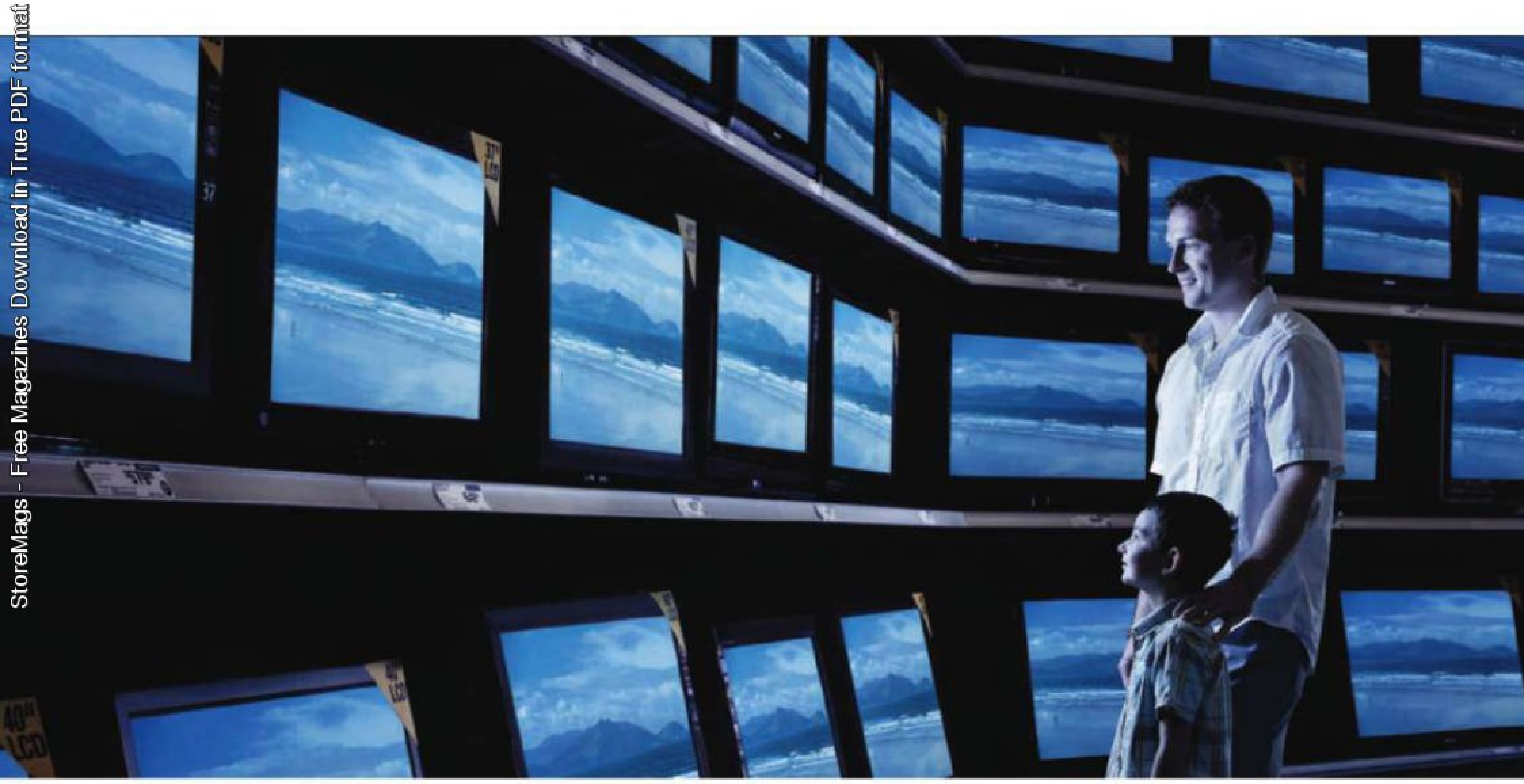
The recent visit by Saudi Arabia's King Abdullah to a New York hospital for back surgery was a reminder of an unsettling issue with global implications: Who will succeed the 86-year-old monarch? The king, who is recovering and has started physical therapy, has been a stabilizing influence in the Middle East and has carefully embraced economic and societal reform. The question is whether his successors will continue his work or whether Saudi Arabia's liberalization will stall.

King Abdullah's father, Abdul Aziz, formed the kingdom in 1932 from a land of warring tribes and modest settlements. Poverty and illiteracy were widespread. Even today, Saudi leaders must manage the trick of letting in enough fresh air to nurture economic and social growth while not offending conservative sensibilities. Depending on who receives the nod, recent progress in modernizing the economy and other reforms including better treatment for women could prove vulnerable. Also possible is paralysis under an enfeebled ruler, as most of the other surviving sons of Abdul Aziz are elderly. "Succession is really a problem," says Mohammed al-Qahtani, a Riyadh-based democracy advocate. "We don't know what is going to happen."

The future is hard to predict because the royal family's senior members are ultra-secretive about their thinking. Two princes are thought by most analysts to be next in line. One is Sultan, the Crown Prince and Defense Minister. He is 82 and in very

HASSAN AMMAR/AFP/GETTY IMAGES

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Prince Nayef, in line for the throne, is opposed to reform

poor health. Yet he was recently flown back from his palace in Morocco to take charge in Abdullah's absence.

The other possibility is 76-year-old Prince Nayef, the Minister of the Interior, who controls the domestic security services and the religious police. According to Mark Weston, author of a book on the kingdom called *Prophets and Princes*, Nayef opposes reform because he doesn't think Saudi Arabia needs fixing. "I have said it clearly: 'No to change,'" Nayef told the *Saudi Gazette* in 2003. "However, there is scope for development." He has declared himself a skeptic on women's rights and elections. "Some of the social reforms would slow a little further under his stewardship without really going into reverse," says Gerd Nonneman, professor of international relations at the University of Exeter in Britain. Even if neither of these front runners becomes king, it is likely that the royal family will tap another prominent son of Abdul Aziz, says F. Gregory Gause III, an Arabist at the University of Vermont. Abdul Aziz had 45 sons, and many survive, including Salman, 71, the governor of Riyadh.

Abdullah formally assumed power from his brother in 2005, though he had been de facto ruler for a decade. He has been a vigorous and progressive leader. A man of modest tastes who lacks formal education, he founded the kingdom's first coeducational university; raised oil production capacity by about a third, to 12.5 million barrels per day; modernized financial services; and presided over an economy that, despite some hiccups in the banking system, rode out the global recession more smoothly than neighbors Kuwait and Dubai. Abdullah has relied on technocrats such as Oil Minister



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Global Economics

Ali Al-Naimi, and Abdul Rahman al Tuwaijri, who heads the Capital Market Authority, to set sensible policies. He has improved relations with the U.S. since the alliance hit its nadir after the terrorist attacks on September 11, 2001, and has made sure that Saudi crude flows to the U.S. unhindered by political considerations.

The king used Saudi Arabia's roughly $400 billion in financial reserves to fund a stimulus package that kept real gross domestic product growth, expected to be 3.5 percent this year, from falling below 0.6 percent last year. "Without the high-powered spending, the kingdom would not have been able to break competitively into the 21st century," says John Sfakianakis, chief economist of Banque Saudi Fransi in Riyadh.

A changing of the guard may already be happening by stealth. Sultan has installed his son, Khaled, 61, as chief of the regular military. He ran the recent war against Yemeni insurgents on the kingdom's southern border. Nayef's son is in charge of the Interior Ministry day to day and has led the counterinsurgency effort against al Qaida militants. Abdullah recently put his own son in command of his main power base, the tribal national guard. For global leaders and businesspeople who would like Abdullah's progressive policies to continue, the best hope is that the younger generation will persuade its uncles and fathers to keep relying on capable technocrats, and that a U-turn toward the past would not be smart politics.
—Glen Carey and Stanley Reed

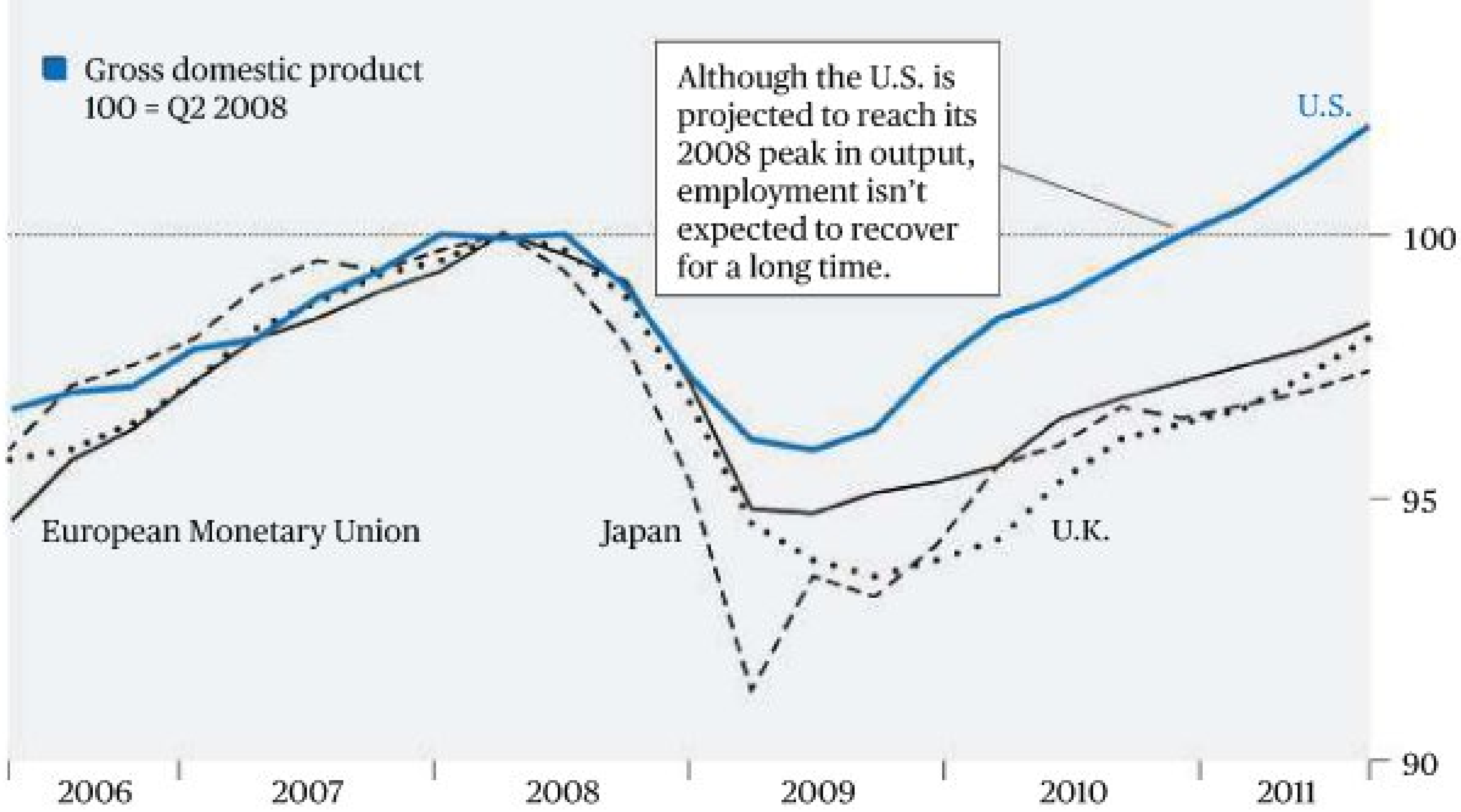
The bottom line *Saudi King Abdullah has been a progressive ruler. The question hanging over the kingdom is if his successor will be a reformer, too.*



Global Recovery

GDP: Feels Like It's 2008 All Over Again

The U.S. economy will surpass its 2008 peak in gross domestic product during this quarter, two years ahead of its developed market peers, predicts David Hensley, director of global economics coordination at JPMorgan Chase. The economy grew at a 2.5 percent annual rate in the third quarter. The jobless rate, though, remains a painful 9.6 percent.



DATA: BLOOMBERG

Commodities

India's Ancient Spice Markets Heat Up

▶ Prices of turmeric and pepper take off, and speculators move in

▶ "A person who has got a lot of money can sway the markets"

In his office above a room stacked with jute sacks of turmeric, Deepak Shah is extolling the virtues of the spice. "It's very good for health, it's used in cooking, in cosmetics, and it's medicinal," says Shah, owner of **P. Amratlal & Sons**, a trader at Mumbai's wholesale Vashi market.

It's also expensive. Rising demand and falling stockpiles, as well as market speculation in the curry ingredient, have pushed up the quoted price of turmeric 114 percent this year, to a recent 15,806 rupees per 100 kilograms, or $348 for 220 pounds on India's National Commodity & Derivatives Exchange. Turmeric's advance is more than eight times the gain of India's benchmark stock index. "Spices, especially cardamom, pepper, and turmeric, are contributing to overall inflation," says Harish Galipelli, vice-president at Kochi-based JRG Wealth Management, a commodity broker.

India controls 42 percent of the $2.8 billion world spice trade and consumes 90 percent of what it grows. Growing affluence in India is driving up local demand, while Westerners are consuming more spices as well. "My customers get angry at me, as if I have con-


Ground turmeric

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Shah: "It's very good for health, it's used in cooking, in cosmetics"



trol over the prices," says Namdev Jagannath, owner of **Namdev Jagannath Sopariwala**, a spice retailer started half a century ago by his father in Mumbai. "We have to pass on the costs."

Turmeric's jump in value has prompted some market players to view it and other spices as commodity investments like gold or copper. "There's a lot of speculation," says Prakash Namboodiri, general manager of AB Mauri India, a unit of **Associated British Foods**. "A person who has got a lot of money can sway the markets"—and a smart one can make a lot of money trading in spices. Average daily turnover as measured by the value of spice futures on the commodity exchange in September doubled, to 6.6 billion rupees, from a year earlier.

Much of India's physical spice trade takes place in wholesale markets like Vashi, 22 miles (35 kilometers) northeast of Mumbai's business district. Shops display cardamom pods, cinnamon bark, tamarind, and open sacks of deep red chilies under the glare of naked electric bulbs. Telephones ring endlessly as electric fans push the warm air.

Demand for turmeric and spices of all kinds is expected to keep rising. "In 40 years we have basically tripled the use of spices in the U.S., and those trends are taking place in other countries, particularly in Europe," says Al Goetze, chief spice buyer with **McCormick & Co.** in Maryland, the world's largest processor of spices. "Consumers today are more interested in more flavorful foods." —*Madelene Pearson*

The bottom line *Turmeric, a key ingredient in curry, has risen sharply in price because of increased demand and low inventories.*

FROM TOP: ADEEL HALIM/BLOOMBERG; FOODFOLIO/ALAMY

Savings Rates

Banks Rediscover The Humble Saver

▶ Despite interest rates near zero, consumers flock to banks

▶ "The banks that have stable funding will inherit the earth"

The interest a consumer in the U.S. can earn on his or her savings account is insultingly small these days—just 0.80 percent on average in October, vs. 3.38 percent in October 2007, according to Market Rates Insight, a provider of financial rate data. Most checking accounts don't even pay interest.

Such tiny or nonexistent returns should encourage consumers to yank their savings from the bank and seek higher yields elsewhere. These are not normal times, though. Since October 2007, says Market Rate Insight, deposits at banks and credit unions have increased by $1 trillion, to $7.74 trillion, an all-time high.

What's going on? Traumatized by the recession, households are saving more. The savings rate has averaged 5.7 percent of disposable income this year, up from 3.1 percent in the prior decade, according to the Commerce Dept. The newly thrifty have to put their savings somewhere. Says Nancy Bush, an independent bank analyst based in Annandale, N.J.: "Deposit levels in the banking system will be higher than in the past because consumers will be spending less and saving more, even when the economy picks up."

Consumers are opting for safety over income when they stash their money in the banks. That means picking savings or checking accounts at FDIC-insured banks. Savers also lean toward savings and checking accounts because they offer instant access to their funds, as opposed to certificates of deposit, which offer a higher yield but penalize holders who want to withdraw funds early.

The surge in savings has increased the importance of so-called core deposits for commercial banks. **Wells Fargo**, the fourth-largest lender by deposits, and fifth-ranked **U.S. Bancorp** have said they're competing for

Speed Dial Mehmet Simsek

Turkey's Finance Minister talks with *Bloomberg Businessweek* Chairman Norman Pearlstine on how Turkey's past crises compare with those of the EU

What can Greece, Ireland, and other troubled members of the European Union learn from Turkey?
We didn't put an end to years of crises until we convinced the markets we had a credible program to impose fiscal discipline on ourselves. We significantly reduced the ratio between debt and gross domestic product. We liquidated troubled banks. And we made it clear going forward that we would hold shareholders, bank managers, and, in some cases, their families personally responsible if they caused their banks to fail. Greece, Portugal, Spain, and Ireland, as members of the euro zone, were never really penalized for poor fundamentals.

Has the EU's turmoil made Turkey less interested in joining it?
The EU accession process is, in my view, more relevant than the endgame. The European Commission has just released a report that essentially says Turkey has made progress on all fronts. We are converging with Europe with regard to per capita GDP, but the process also helps with political and social transformations.

Can Turkey cut its jobless rate?
Between 2007 and 2010, Turkey added 2.8 million jobs. Unemployment is still above 11 percent, but our recovery hasn't been jobless. Our banking sector's balance sheet is very strong. It can support growth, as can our public sector balance sheet. We are focusing investments on human capital, infrastructure, R&D, and education.

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such funds, which include checking and savings accounts and time deposits of less than $100,000. Banks have relied more on these deposits for funding since the freeze in credit markets sparked the financial crisis.

The industry must shift from raising funds in debt and securitization markets to increasing core deposits. "Other sources of funding are drying up," says R. Christopher Whalen, a former Federal Reserve analyst and co-founder of Institutional Risk Analytics in Torrance, Calif. "The banks that have stable funding will inherit the earth."

Banks consider core deposits more dependable in times of stress since customers with checking and savings accounts are more likely to keep their money in the bank than investors are likely to purchase new bank bonds. Borrowing by U.S. commercial banks fell 17 percent since July of last year, while deposits increased 9 percent in the same period, according to the Fed.

5.7%

Current U.S. household savings rate, up from 3.1% in the last decade

Deposits funded 81 percent of banks' growth in loans and securities during the third quarter, the FDIC said on Nov. 23. "One of the most overlooked aspects of the current cycle is the shift in funding," says Todd Hagerman, a banking analyst in New York with Collins Stewart, a London-based brokerage. "We're seeing ongoing deleveraging," he says, which means "more reliance on core funding sources."

Core deposits are also valued because banks can easily lend the money at higher rates than they are paying depositors, or profit just by purchasing Treasuries. Customers who provide core deposits, particularly those with checking accounts, are thought to be the most loyal, says Richard C. Hartnack, a vice-chairman and head of consumer and small business at Minneapolis-based U.S. Bancorp. "We're acting as a safe storage place for people's liquidity," he says. "As long as we do a good job, most clients are happy with the proposition."

—*Dakin Campbell*

The bottom line *Americans are saving much more than in the last decade, and at lower rates. Those savings are boosting deposits at U.S. banks.*

Seven Days

Events of note in the week ahead

by Ira Boudway



06

Euro zone Finance Ministers meet in Brussels

Manpower's survey on the hiring outlook in China for the first quarter of 2011

▶ **U.S. Employment Trends Index:** The Conference Board anticipates sluggish job growth until at least mid-2011.



07

Japan's Leading Economic Index

Pearl Harbor Day



▶ **U.S. Consumer Credit:** Borrowing unexpectedly increased by $2.1 billion in September. Surveyed economists expect a $500 million decline for October.

08

Germany's trade balance for October

Japan's third-quarter GDP

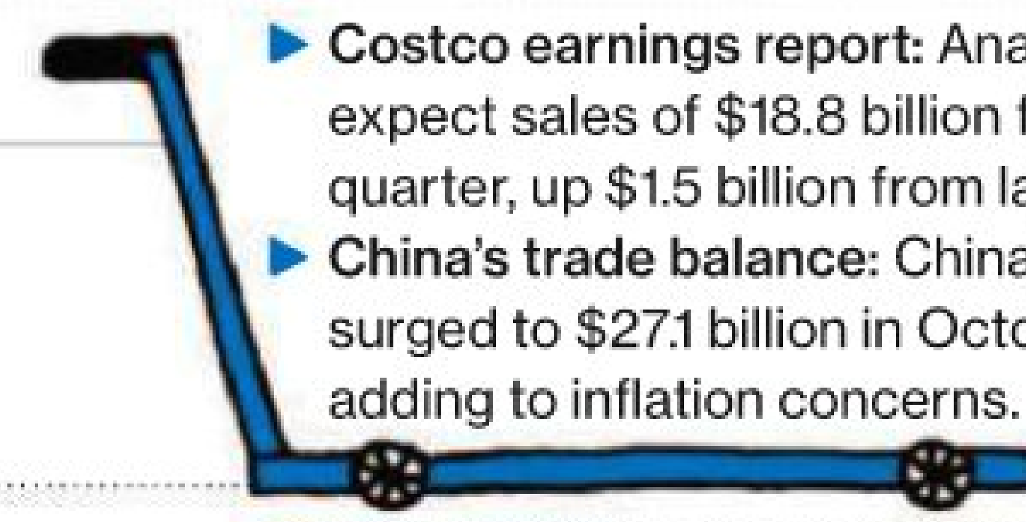
▶ **Polish President's U.S. visit:** Bronislaw Komorowski is scheduled to meet with President Obama at the White House.



09

U.K.'s Leading Economic Index

Brazil's third-quarter GDP

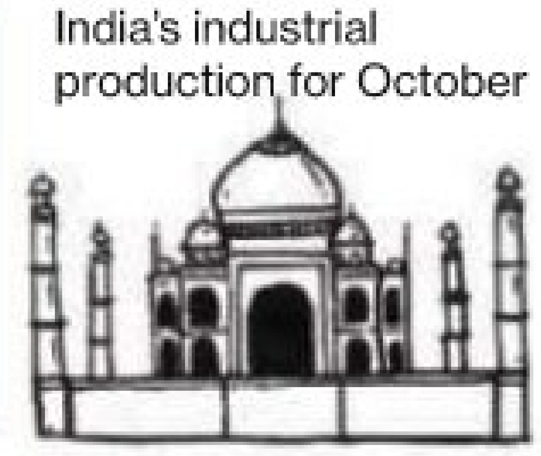


▶ **Costco earnings report:** Analysts expect sales of $18.8 billion for the quarter, up $1.5 billion from last year.

▶ **China's trade balance:** China's surplus surged to $27.1 billion in October, adding to inflation concerns.

10

India's industrial production for October



▶ **U.S. monthly budget statement:** The deficit narrowed to $140.4 billion in October. Surveyed economists project a gap of $130 billion for November.

11

College football: Army vs. Navy at Lincoln Financial Field in Philadelphia



▶ **Madoff deadline:** Last day for investors defrauded by Bernard Madoff's $65 billion Ponzi scheme to file suit via bankruptcy trustee Irving Picard.

12

English soccer: Tottenham Hotspur vs. Chelsea

▶ **China's November data:** The world's second-largest economy reports on consumer and producer prices, retail sales, and industrial production.



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Companies&Industries



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Forget Hemlines. Ties May Be the New Indicator

▶ **Armed with renewed confidence, men are heading to stores in greater numbers this season**

▶ **"I feel more comfortable about the economy," says a shopper**

The last time Ray Lopez bought a suit, Lehman Brothers was still standing. Now the managing partner at Greensboro (N.C.) private equity firm Shamrock Capital Partners is ready to go wardrobe shopping again. Lopez, 43, plans to drop as much as $1,500 at **Jos. A. Bank** on two pinstriped suits, white dress shirts, and a handful of ties: "I feel more comfortable about the economy. Plus I'm seeing these big discounts everywhere."

Lopez represents a highly prized class of customer this holiday season: men with money to burn. According to an October survey conducted by BIGresearch, men plan to spend about 3 percent more than they did in 2009; women planned to spend about 1 percent less. The previous year, both sexes cut back.

Retailers say more men swarmed America's malls and stores during Black Friday weekend this year than last. At the **Macy's** Manhattan flagship, Chief Executive Officer Terry J. Lundgren saw "a lot more men than I'm used to seeing" on the day after Thanksgiving. Like Lopez, many were buying stuff for themselves, adds the Macy's chief.

Men spent an average of $100 more than women—about $417—during Black Friday weekend, according to the National Retail Federation. They are less likely to comparison shop than women and so are less aware of price. No wonder store owners are keen to keep them shopping right through the New Year. This year guys are buying what guys usually buy: 57-inch flat-screen TVS, iPads, and game consoles. They are also loading up on apparel, and retailers are eager to win their favor. **Saks** is selling $395 alligator belts, **Nordstrom** has $325 Chukka boots, and **Coach** is offering $598 man bags.

Men intend to spend 3 percent more this year than in 2009, while women plan to spend 1 percent less

Yes, women are still the Olympians of full-contact shopping; not for nothing do retail executives traditionally refer to their customers as "she." Yet even as the recovery bumps along, men seem more secure about their finances than women. A consumer survey conducted in August by WSL Strategic Retail shows that nearly half of men believe their finances would improve, while only a third of women do. Two years ago, men were about as pessimistic as women.

Retailers have stepped up their outreach to male shoppers in recent years—and not just to young, urban dandies. **J.C. Penney** has reorganized its menswear, grouping items by category in addition to brand. The move is designed to appeal to older men, who prefer to shop for, say, pants or sweaters rather than entire outfits or particular labels. The department store chain also added brands such as JOE Joseph Abboud and Claiborne, whose updated classics appeal to 25- to 45-year-old shoppers. Coach, too, is chasing men. Earlier

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this year the purveyor of luxury leather goods opened its first standalone men's store in New York and plans two more—in Boston and Paramus, N.J.—next spring. New arrivals at Coach's online men's store include $198 messenger bags and $798 down puffer jackets with fur collars.

Saks, which generates about 14 percent of its annual sales from men, is, in the words of President Ronald L. Frasch, "prudently" boosting its inventory of men's apparel. The department store is putting a particular emphasis on exclusive merchandise, such as the Saks Fifth Avenue Men's Collection, which features $795 travel blazers and $135 dress shirts.

When the stock market crashed in 2008, many of his male customers "took a breather," says Bob Mitchell, co-president of **Mitchells Family of Stores**, which operates five upscale clothing emporiums in Westport and Greenwich, Conn., on Long Island, N.Y., and on the West Coast. Now they're coming back. "The first weekend of holiday shopping was very positive in men's sportswear and ties," Mitchell says.

Don Guffey, whose eponymous men's store in Atlanta caters to bankers, real estate brokers, and entrepreneurs, ascribes the best sales in two years to the change of political leadership in Georgia and in Washington. His customers "believe the direction of business is going to change," says Guffey, whose store stocks Oxxford Clothes and Ravazzolo suits starting at $2,500 apiece and $135 Robert Talbott neckties. "They believe the economy has bottomed out."
—*Lauren Coleman-Lochner, Cotten Timberlake, and Chris Burritt*

***The bottom line** Retailers say they're seeing more men in their stores this year. And so far, those men are spending more than women.*

Quoted

"I don't think one treaty can work for the world.... You can't judge India's progress with the same metrics as U.S. progress."
—Coca-Cola CEO Muhtar Kent speaking from Cancún, where global climate talks are under way





Joyce (foreground) moved swiftly to keep travelers' confidence

Airlines

Qantas' Strategy to Reboard Passengers

- **CEO Alan Joyce gets kudos for his deft handling of a crisis**
- **"[Joyce] gets people to raise their game," says a former colleague**

On Nov. 27, less than a month after one of **Qantas Airways'** Airbus A380s had a midair engine explosion, the airline sent its first 450-seater back into service for a Sydney-to-London flight. Despite the Nov. 4 blowout and subsequent problems with other of the fleet's A380s, one passenger was particularly eager to board this flight: Alan Joyce, Qantas' 44-year-old chief executive officer.

Joyce's flight followed a media blitz of five press briefings, at least six radio and television interviews, and a YouTube video address. In an e-mail response to questions, Joyce noted that "During crisis situations you can never communicate enough."

Hours after the Nov. 4 incident, Joyce grounded Qantas' six A380s. (The cause of the engine explosion is still being investigated by the Australian Transport Safety Bureau.) His swift action and heightened visibility have helped Sydney-based Qantas retain travelers' confidence, says Robert Heath, a crisis management consultant and professor at the University of South Australia.

Investors are less assured: Qantas' stock has fallen 10.8 percent since Nov. 3 in Sydney trading, compared with a 3.2 percent decline for the benchmark S&P/ASX 200 index. Even so, UBS analyst Simon Mitchell on Nov. 23 affirmed a buy rating on the airline, a recommendation made by 12 of the 14 analysts tracked by Bloomberg.

Joyce's management of the crisis began with a televised press conference on Nov. 4 after the A380 made an emergency landing in Singapore. The Rolls-Royce-powered aircraft touched down with the rear of an engine cover blown away from the explosion and damage to a wing and its fuselage. No one on board was hurt. Since then the carrier has used substitute planes, including Boeing 747s, to maintain services usually flown by the A380s.

In early December, a second Qantas A380 will start flying, followed by two new ones within the month. Qantas is working with **Rolls-Royce Group** on modifying as many as 16 engines.

The Qantas CEO's actions contrast with **Toyota Motor** President Akio Toyoda's handling of U.S. recalls that began last year. Toyoda didn't hold a press conference after the company announced defects with 3.8 million vehicles in September 2009. He waited

CLOCKWISE FROM TOP: DANIEL MUNOZ/REUTERS; FINSBURY LTD./BLOOMBERG; RAMIN TALAIE/BLOOMBERG

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more than a week to give a briefing after a separate recall in January. Instead, U.S. sales chief James E. Lentz and Executive Vice-President Shinichi Sasaki spoke for the company. The Toyota brand's share of U.S. auto sales fell to 13 percent in the first 10 months of 2010 from 15 percent in 2009. "Toyoda really should have been out in front from the beginning," says Tadashi Usui, a Tokyo-based analyst at Moody's Japan.

Joyce, Qantas' CEO since 2008, gets high marks for management from Conor McCarthy, a former colleague at **Aer Lingus** who is now CEO of aircraft maintenance firm **Dublin Aerospace**. "He gets people to raise their game," says McCarthy. "I think customers will have a lot of confidence he was making the right decisions."

Good decisions won't matter if more engine troubles crop up. A Qantas Boeing 747 returned to Singapore because of an engine fire on Nov. 5, and at least two other Qantas planes have turned back since because of trouble. While Ron Bishop, senior lecturer in aviation technology at Central Queensland University, is impressed by how Qantas has handled events, any more faults and "everybody around the world will be looking at Qantas and asking themselves questions," he says. —*Robert Fenner*

The bottom line *The Qantas CEO's swift damage control in the wake of an Airbus 380 midair engine blowout has impressed crisis consultants.*

Commodities

A Banking Scion Wants To Be the King of Coal

▸ **Nathaniel P. Rothschild is leading a $3 billion Indonesian takeover**

▸ **"Rothschild has the nerve to call up anyone, and... he's taken seriously"**

Even as representatives from 190 nations gather in Cancún, Mexico, to have another go at hammering out a global treaty to curb greenhouse gas emissions, Nathaniel Rothschild dreams of becoming the world's largest coal producer. A member of the storied financial clan that helped bankroll Britain's war against Napoleonic France, the future fifth Baron Rothschild is leading a $3 billion deal to create an Indonesian coal powerhouse that would be ideally positioned to profit from China's voracious appetite for the fuel.

To get there, Rothschild is leveraging his name, hedge fund experience, and a network that reads like a who's who of the commodities world. He's friends with Ivan Glasenberg, head of the commodity trader Glencore International; advises Russian aluminum billionaire Oleg Deripaska; and is on the board of Barrick Gold, the largest gold miner. "There's no global coal company today," says Rothschild, 39. "There's not a Barrick Gold in coal. That's where the opportunity is."

Rothschild has been searching for a natural-resources acquisition since **Vallar**, the U.K. investment company he founded, raised $1.1 billion in an initial public offering in London in July. Potential deals with **Polyus Gold**, Russia's largest producer of the metal, and Moscow-based iron-ore miner **Metalloinvest** didn't pan out. Then in October, Rothschild traveled to Los Angeles to meet Nirwan Bakrie, a member of the family that controls **Bumi Resources**, Indonesia's largest coal producer. Things fell into place quickly. On Nov. 16, Rothschild announced a three-way merger that combines Vallar, 25 percent of Indonesian coal producer Bumi Resources, and 75 percent of **Berau Coal Energy,** another Indonesian miner. The Southeast Asian nation has displaced Australia as the world's biggest exporter of what is known as power-station coal. Prices for the fuel have shot up 40 percent this year, according to Morgan Stanley, because of strong demand from China and India. Together the two countries burned more than half the world's supply of coal last year. "Indonesia is a sleeping giant," Rothschild says. "One scratches one's head to think why isn't there a mining champion out there already, and hopefully we are in the process of showcasing one in the years ahead."

Before setting up Vallar, Rothschild spent more than a decade at hedge fund firm Atticus Capital in New York. The firm generated almost $7 billion for investors before most of its funds were wound up last year. Rothschild says his work at Atticus immersed him in commodities, which became his "strongest suit." He also got to know some of the industry's most influential people. "He has an unparalleled range of contacts," says Peter Munk, Barrick's founder and chairman. "Certainly being a Rothschild does help, but opening a door, if you're an idiot, it's a single event. He has shown a talent."

Rothschild is the only son of British financier Lord Jacob Rothschild, the fourth Baron Rothschild, a former banker and modern art collector. Nathaniel attended Eton College, the English private school that counts 19 British prime ministers as former pupils, and is dating Princess Florence von Preussen, the great-great-granddaughter of the last German emperor, Kaiser Wilhelm II, according to the U.K. tabloid *Daily Mail*. After studying history at Oxford University, Rothschild decamped to New York (he owns homes in Manhattan and Paris), where he held a series of jobs in finance. That world was already familiar to him, says Rothschild, who as a youth ➜



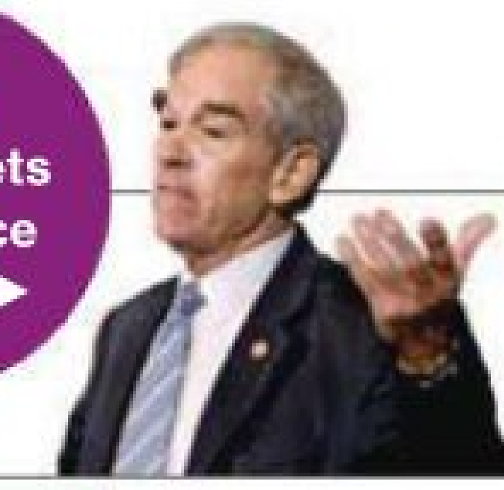
Nathaniel Rothschild

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A Fed basher gets his chance page 35 ▶



frequently accompanied his father on business trips: "I was exposed at a very, very early age to a lot of these big Wall Street tycoons."

While at Atticus, Rothschild established his relationship with Deripaska. They first met in Paris in 2002 at a meeting where "the average age was considerably older than our average ages," he recalls. "We ended up going out and having dinner." Rothschild now chairs the board of EN+ Group, the holding company through which Deripaska controls assets including United Co. Rusal, the largest aluminum maker. "Ivan Glasenberg or Oleg Deripaska, they've come from nothing; they are not impressed by posh blokes," says Michael Rawlinson, a banker at Liberum Capital in London who met the British scion during a stint in New York in the 1990s. Rothschild has "the nerve to call up anyone, and what's interesting is he's taken seriously."

Rothschild's connections and deep pockets make him an attractive partner for Indonesia's Bakrie clan, which helms a palm-oil-to-property empire. "They just can't rely on Indonesian banks for borrowing. They must, must seek funding from outside Indonesia," says Jakarta-based Adrian Rusmana, a director at broker Sucorinvest Central Gani. "This alliance with Rothschild gives them access to European financiers, bankers, investors, and markets."

Rothschild on Nov. 16 outlined plans to boost annual coal production to 140 million metric tons by 2013, equal to all of South Africa's output last year. "They will control a large part of global seaborne-traded coal," says David Chang, a director at brokerage UOB Kay Hian Securities Indonesia. "This will give them some influence on coal supply and therefore coal prices."

The new company, **Bumi PLC**, will be the first major Indonesian business to list on the London Stock Exchange, where miners figure prominently among the top 20 companies on the benchmark index's market value. "To be able to do an IPO without having any assets, he has to be somebody," Indra Bakrie, who will be Bumi's chairman, says of Rothschild. "I wish I could do that."

—Jesse Riseborough and Simon Casey

The bottom line *Nathaniel Rothschild has parlayed his family and work connections into a $3 billion deal aimed at creating the world's biggest coal exporter.*

Luxury Retailing

Chinese Shoppers' Long March Through Europe

▶ Spending by mainland tourists is boosting European luxury sales

▶ "The cherry on the cake is the Chinese tourists"

Ice Fu plans to pack light when she travels to Paris this month. The 28-year-old restaurant owner from Shenzhen in southeastern China needs to leave room for the Chanel, Hermès, and Louis Vuitton handbags she's intending to buy. "We have Chanel shops in China, but they're always out of stock," says Fu. "The Hermès bags I want to get still aren't available in China."

Even as makers of luxury goods are racing to open new stores in China, they're finding their European flagships mobbed by tourists like Fu. Around 2.5 million mainlanders visited Western Europe this year, 500,000 more than in 2009. And that number is expected to climb to 3 million by 2012 as incomes continue to grow, according to U.K. forecaster Oxford Economics. The Chinese now account for at least a quarter of European luxury goods sales, estimates Luca Solca, an analyst at Sanford C. Bernstein. Their buying power has been bolstered by the yuan's 12 percent rise against the euro this year. "The classic shoppers on Place Vendôme in Paris used be stars, celebrities, members of royal families from the Middle East in big limousines," says Uché Okonkwo, executive director of Paris-based consultancy Luxe. "Today, it's Chinese tourists that are brought in by big buses in groups."

Mainland Chinese spent $23.4 billion in 2009 on luxury handbags and suitcases, shoes, watches, jewelry, clothes, cosmetics, and perfumes, according to a Nov. 9 report from **Bain & Co.** More than half of that was purchased overseas. The trend is buoying the luxury goods industry, with sales in Europe on course to grow 6 percent this year, after falling 9 percent in 2009, according to Bain's forecasts.

"The cherry on the cake is the Chinese tourists who bought not only in Asia but also in Europe," said **Hermès** Chief Executive Officer Patrick Thomas at the opening of a new Paris store in November. Visitors from China helped lift European sales 19 percent at Hermès and 13 percent at **LVMH Moët Hennessy Louis Vuitton** this year through September, excluding currency moves, say the companies. At Gucci, where nine-month European sales rose 9.9 percent on the same basis, spending by Chinese tourists dou- ➔ 32

Lust for Labels

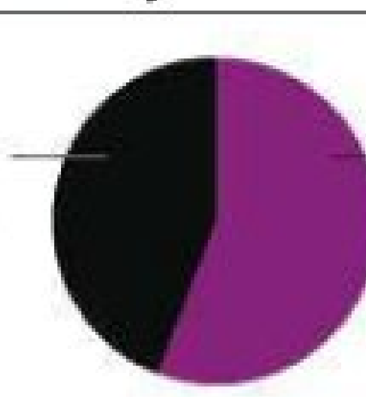
Chinese consumers have greater buying power and more choice

Luxury Stores Opened in China This Year:

80

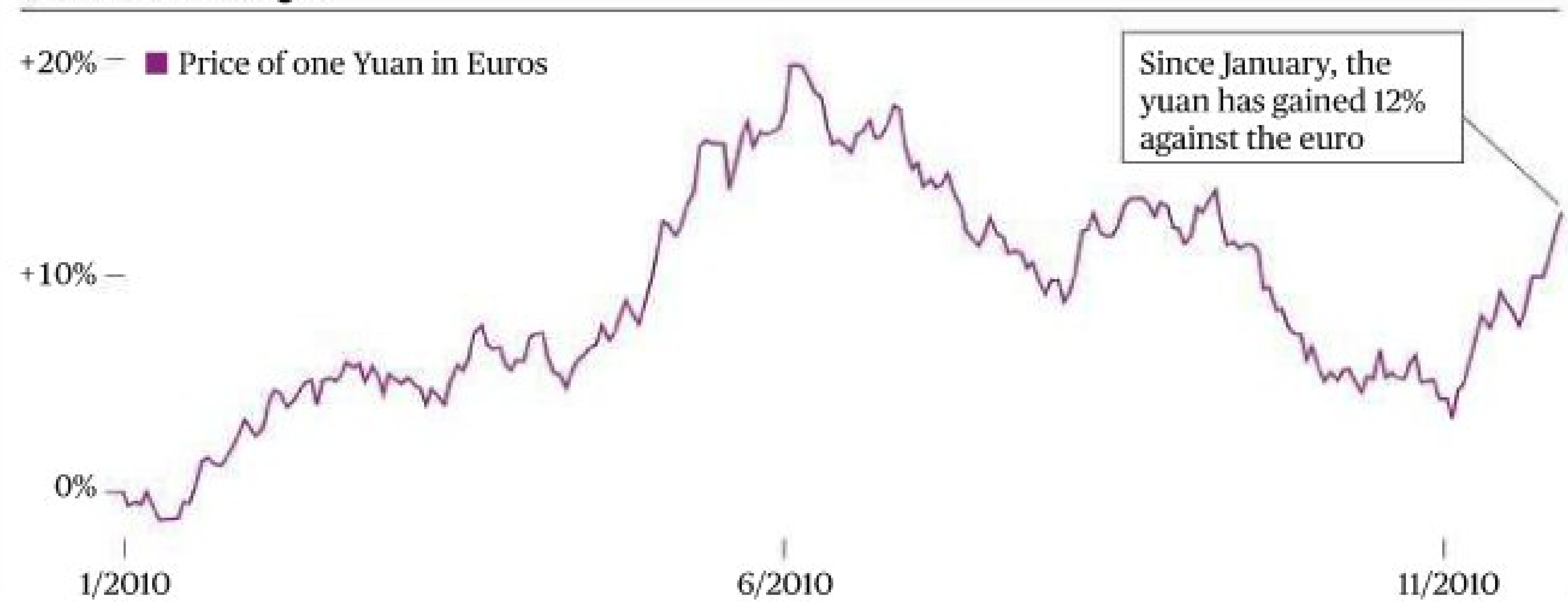
Includes brands such as Gucci, Versace, Louis Vuitton, Prada, and Cartier (estimate)

Luxury Purchases by Chinese Consumers*



*Based on 2010 survey

The Yuan's Strength



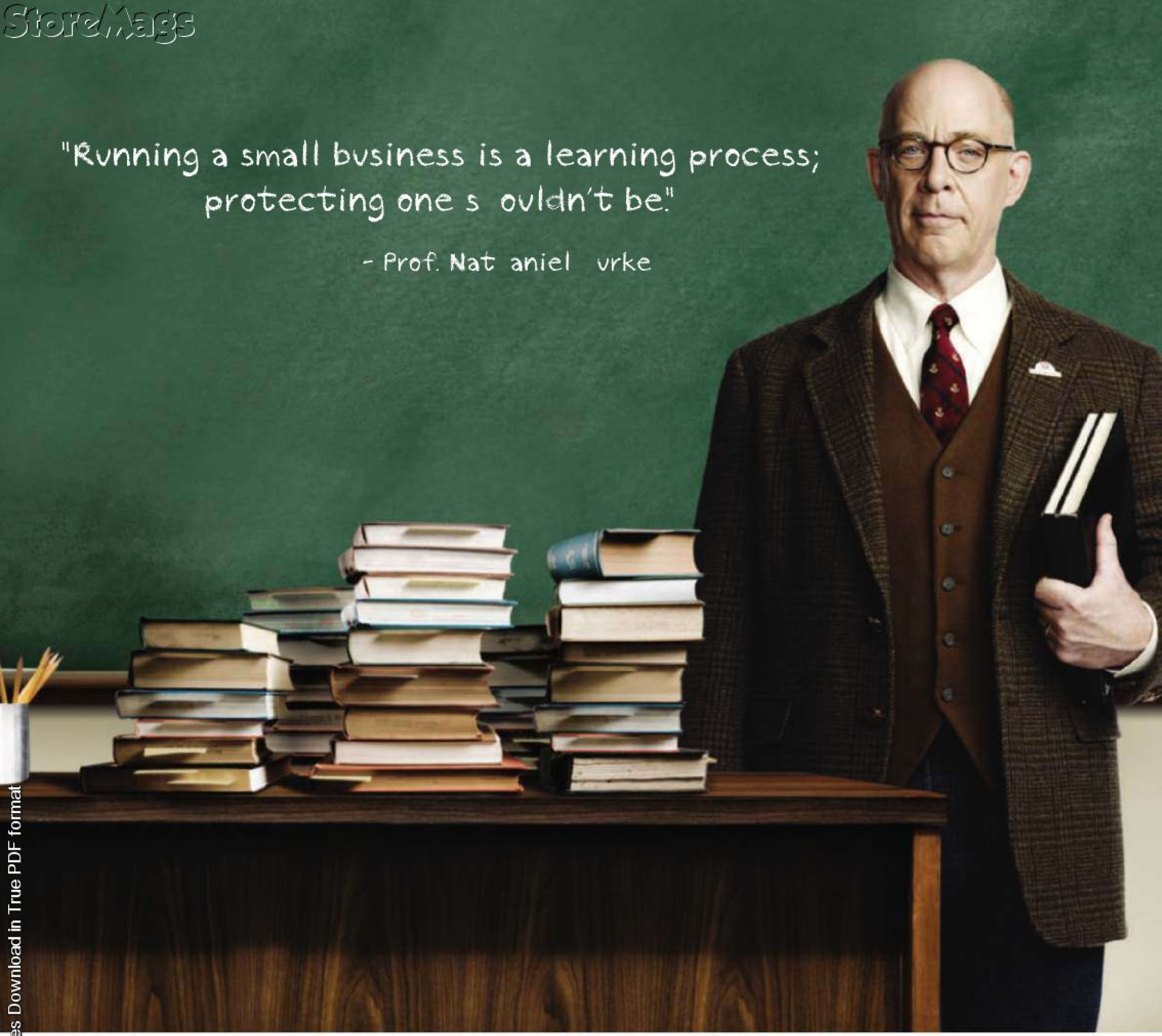
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Charlie Rose talks to

Mike Duke



Wal-Mart's CEO discusses the company's new focus on smaller stores, its failure in Germany, and a deal that gives it a foothold in Africa

Wal-Mart knows numbers. So what do the numbers from the Thanksgiving period tell you about the state of retail in America in 2010?
We do look at a lot of numbers. But this would be like looking at a football game after the first three or four minutes and trying to predict the outcome. I wouldn't dare try to give any indication about Christmas. I would tell you, though, that we feel that we are very well positioned. We feel that the consumer is smarter today, loves shopping smarter, is proud of the fact that they are shopping smarter. And that, we believe, fits well with where we are positioned for Christmas.

In terms of the company's revenues, you've predicted that they could go up or down.
What we've said, going into this fourth quarter, is that for Wal-Mart's U.S. business, we had a range that was slightly positive to slightly negative. It's a range Bill Simon, who is the president of Walmart U.S., provided as guidance at our October analyst meeting. And in the Sam's business, Sam's U.S. had similar guidance, a little more on the positive side.

Is the international market where Wal-Mart's growth is going to be?
We actually have a lot of growth opportunity here in the U.S. So I would say it's both in the U.S. and in the international markets. Seventy-five percent of our business is still here in the U.S. And here in New York City and other urban markets, there is a big opportunity. We've started more initiatives in U.S. urban markets, including small stores.

In Chicago. In New York.
That's right. We said Chicago initially. We've also announced our intention in Washington, D.C. We have four sites that are under development at this point that we really want to open in D.C. We don't have anything to announce about New York. But we see a lot of customers here.

How are you being affected by the surge in e-commerce spending?
Well, we've seen with our own site and our own purchases online that customers really, really want the information that e-commerce, that Walmart.com, can bring them about the products they're buying. This past weekend, our traffic has been up about 30 percent, so more customers are going online. They either buy online, or they research and buy in the store.

Prior to being CEO, you ran Wal-Mart's international division. Tell me about that side of the company.
The big emerging markets, like Brazil and other Latin American countries, India, and China, have just tremendous opportunity. In almost all of them, there's a rising middle class.

And Africa is part of your plans.
We've been looking at the sub-Saharan countries and particularly South Africa now for couple of years. I've walked the townships, and I've seen the opportunity with millions of customers. ... We have had a very good relationship with Massmart, a company based in South Africa, with operations now in 14 countries, and thus our announcement that we are going to be investing and would like to acquire 51 percent of Massmart.

When you ran international, you shut down operations in Germany. What was the lesson?
There were probably several [including] how we do due diligence and how we respect the local customer. We are a global company, but we serve customers locally and we really need to respect and appreciate their local taste. .... That's why when you visit our stores in China you'll see that it says Wal-Mart and it feels like a Wal-Mart, but when you're in the seafood department, you notice fresh seafood. The fish are live because that's the way the local customer wants to buy a fish.

You recently met with President Obama. What did you tell him?
I would say out of respect for meetings with the President, those meetings in a one-on-one setting would be private.

What did you discuss, in general terms?
Three issues that I would tell you that we often talk about: Tax, trade, and health care are the big three challenges.

What do you worry about?
The thing that is probably the most challenging for a company like ours is continuing to grow the talent for a company that's growing around the world. That's why this is about the opportunity for not only job creation but career creation. We will add thousands of customers. We can add sales to our top line. But it will require leadership.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

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bled to 22 percent of the region's total, according to parent **PPR**.

For mainland visitors, lower prices and bigger selection are the main draw of buying Chanel in Paris vs. Shanghai, a city where the French fashion house now boasts three boutiques. The Chanel Jumbo handbag, or *bao bao* in Chinese, that Fu covets costs more than $4,700 in China, while the Hermès Kelly she's eyeing has a ticket of about $8,800. In Paris, the same bags are priced at $3,900 and $6,500, respectively. Why the differential? China levies import duties of between 10 percent and 20 percent on European handbags, plus a value-added tax of 17 percent.

Europe may be about to lose some luster in the eyes of Fu and her fellow travelers. Gucci plans to raise some prices by more than 5 percent to reduce the spread between Europe and other countries, according to PPR, while Louis Vuitton will lift prices in a "significant way," says LVMH Chief Financial Officer Jean-Jacques Guiony. "An excessive price gap between different markets is confusing," says Michele Norsa, CEO of **Salvatore Ferragamo**. The Italian shoemaker may "rebalance" prices worldwide next year, raising some and lowering others, reports Norsa.

At the same time, European luxury goods makers are giving Chinese consumers more reasons to shop at home. Major luxury brands opened some 80 new stores in China this year through August, estimates Bain. Its report notes that companies are also improving product availability and enhancing customer service to meet growing demand: Luxury sales in mainland China rose 14 percent last year, outpacing an 8 percent rise by Chinese travelers' luxury spending overseas.

Don't expect the crowds of Chinese at Louis Vuitton's flagship on the Champs Elysées to thin out anytime soon, though. Being able to say you bought your bag in Paris adds prestige to the purchase, says Okonkwo: "It's a complete experience, and this is what counts for them." Fu seems to agree. "The mood and atmosphere shopping in Paris are nicer," she says. Ⓑ

—Andrew Roberts and Wendy Leung

***The bottom line** Chinese visitors are flocking to European luxury stores in search of better selection and prices. Retailers are moving to narrow the gap.*

Briefs

by Caroline Winter

Roche, Bristol-Myers Squibb
Price cuts imposed by China

China is slashing the price of drugs made by Roche, Bristol-Myers Squibb, and other pharma companies by about a third as the government seeks to rein in health-care costs and cool inflation. Research group IMS Health forecasts that China's pharmaceutical market will expand at least 25 percent next year, spurred by a new national health insurance system designed to improve medical care. To sell broadly in China, foreign drugmakers must list their products on a government pharmaceutical reimbursement register, which subjects them to price controls. Some companies, though, are lobbying the government to provide greater incentives for research and innovation.



Google
Under EU investigation

Google is being probed by European Union antitrust regulators, who allege the company discriminates against competitors in its search results and prevents some website operators from striking deals to accept ads from the search giant's rivals. Google has denied the charges but says it is prepared to work with the European Commission to address concerns.



Fannie Mae, Freddie Mac
Facing delays, threatening penalties

Fannie Mae and Freddie Mac are meeting resistance in their attempts to push failed mortgages off their books and onto the balance sheets of private banks. The two government-owned mortgage companies have been trying to enforce contracts requiring lenders to buy back loans that didn't meet underwriting standards. By the end of September, banks hadn't responded to $13 billion in buyback requests, according to the companies. Freddie Mac has begun assessing penalties for the delays. Lenders say their underwriting is being unfairly second-guessed and claim that repurchase requests waste government resources, given that about 40 percent are typically rescinded.

Morgan Stanley
A sale in China

Morgan Stanley is selling its 34.3 percent stake in China International Capital Corp. to KKR, TPG Capital, Singapore's Great Eastern Holdings, and the island nation's sovereign-wealth fund, people familiar with the matter say. The deal would end Morgan's 15-year relationship with the first Sino-foreign investment bank. Morgan has planned to sell its stake, valued at about $1 billion, since at least February, partly because Beijing won't allow the firm to take majority control. A sale would let Morgan find a new local partner or build its own investment bank in China. The economic crisis has spurred many foreign investors to dispose of their stakes in Chinese banks for gains.

Seagate Technology
Another IPO deadend

Seagate Technology, the world's largest maker of disk drives, ended talks to be taken private when buyout firm TPG Capital couldn't find partners to raise equity financing for the takeover, according to a person familiar with the matter. A perception that many disk drives could soon be replaced by flash memory may have made a deal less attractive, though Seagate says its sales for the current quarter will be at least $2.7 billion, beating Bloomberg analysts' estimates. The company has seen two failed buyouts this year, and its stock has tumbled 24 percent.



TONY AVELAR/BLOOMBERG

On the Move

Merck President Kenneth C. Frazier will assume the additional role of CEO on Jan. 1 ● **Austrian Airlines** Thierry Antinori named chairman, will start on Apr. 1 ● **TUI Travel** Former commercial director William Waggott promoted to CFO

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Politics&Policy



Ron Paul's Moment

▶ **The Fed critic could chair the House panel on monetary policy**

▶ **GOP leaders have "been working to keep me away from this"**

Retiring New Hampshire Senator Judd Gregg, one of the Federal Reserve's most stalwart Republican supporters, showed up for a meeting at the central bank in November bearing a surprising gift: a box of *End the Fed* books. As he handed out the 2009 best seller by Representative Ron Paul, a longtime Fed critic, Gregg told the gathering it would be worth reading to see what the other side is plotting.

It may have taken 34 years, but Ron Paul has arrived, and he doesn't plan to squander the moment. His agenda includes landing the chairmanship of the House Financial Services Committee panel that oversees monetary policy—a job that will give him the power to push legislation reining in the central bank and to haul Fed governors up to Capitol Hill for hearings.

The prospect has Wall Street, Fed officials, and even Republican House leaders worried that Paul's agenda could roil the markets and make a mockery of the U.S. financial system. This is a man, after all, who entered politics because President Richard Nixon bucked the gold standard in 1971, and now wants to make gold and silver legal tender. He is pressing for an audit of the Fort Knox bullion depository and, earlier this year, grilled Fed Chairman Ben Bernanke about

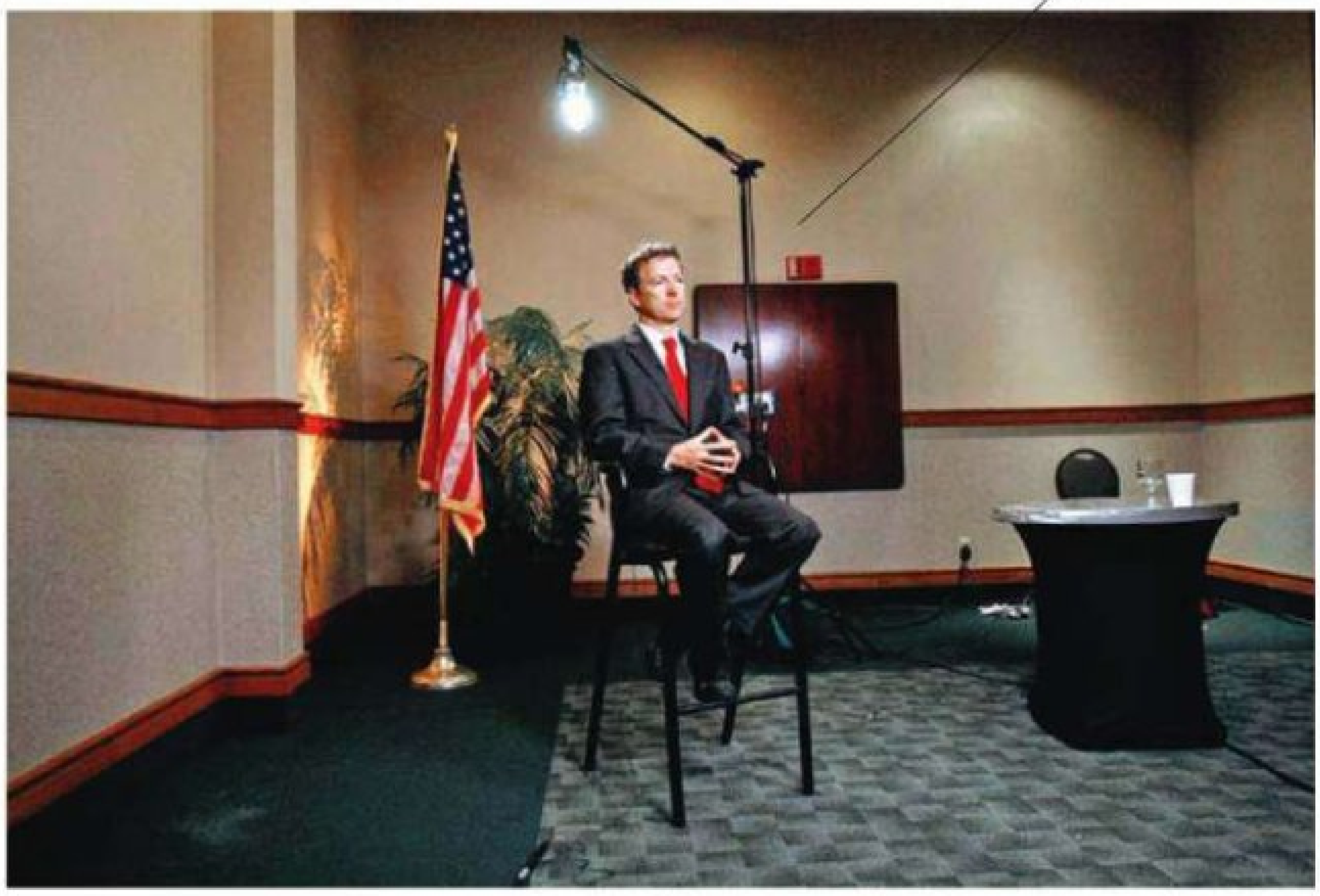
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Paul's son Rand, the incoming Kentucky senator, could get a seat on the Banking Committee



the central bank's alleged funding of Watergate and Saddam Hussein's nuclear program. Bernanke called the charges "absolutely bizarre."

Although his book ploy was couched in humor, Gregg laid plain a new Washington reality: Moderate, probusiness lawmakers like him, who consistently protected the central bank's independence and ability to set monetary policy, are mostly gone. In their place are politicians who view the Fed with suspicion, or worse (page 68). Their unofficial leader is Paul, the 75-year-old Texan whose quixotic 2008 Presidential run on the twin themes of ending the federal income tax and abolishing the Fed vaulted him to prominence with the nascent Tea Party. Some of those admirers are among the 75-plus new Republicans about to join Congress. For the first time since he was elected to the House in 1976, Paul's followers are formidable.

They include his son Rand, an incoming senator from Kentucky who routinely bashed the Fed on the campaign trail and is now angling for a seat on the Senate Banking Committee where he, too, could train his sights on the central bank. Calls to Rand Paul's staff seeking comment were not returned.

Officials at several major banks have privately raised concerns with Republican leaders that, by allowing Paul to become a chairman, his radical views would gain legitimacy, according to three bank lobbyists. Others are watching with great interest. "Congressman Paul has his own very strong views on things, and you've got to respect that," says Steve Verdier, a lobbyist for the Independent Community Bankers of America, which represents smaller lenders and has fought efforts to weaken the central bank. "I think there is a strong consensus in the country to maintain the independence of the Fed," he adds.

If he gets the subcommittee gavel, Paul says he plans a thorough review of Fed policy. Fear of inflation is what motivates him the most. Next to the doorway in his Washington office are six framed German bank notes dating from the 1920s hyperinflation era. The notes are sequentially dated "to show how quickly the zeroes were added onto the bills" as inflation skyrocketed, Paul says. The notes are arranged around a quote by one of Paul's favorite Austrian School economists, the late Hans F. Sennholz, who Paul once met and calls "a tremendous influence on me." Paul is a devotee of the Austrian School, which teaches that manipulating money supply and interest rates are responsible for history's boom-and-bust cycles. "The Fed creates all of the bubbles and they create the inevitable bursting of all of the bubbles," says Paul.

He believes his oversight role is long overdue. "There has been a politically cozy relationship between Congress and the Federal Reserve," he says. That includes past efforts to keep him from heading the subcommittee. "Republican leadership, with the Fed's influence, has been working to keep me away from this for a long time. That's not going to happen this time."

His prediction may be premature. Five GOP leadership aides, speaking anonymously because a decision isn't final, say incoming House Speaker John Boehner has discussed ways to prevent Paul from becoming chairman or to keep him on a tight leash if he does. If Boehner, who will help determine who gets to chair subcommittees as early as Dec. 8, rejects Paul, he may have to contend with thousands of grassroots supporters and dozens of younger lawmakers who see Paul as a hero. Boehner, through a spokesman, declined to comment. "A lot of the older members probably think Ron is a little bit out of step," says Representative Bill Posey, a Florida Republican and unabashed Paul fan. "The depth of his knowledge on monetary policy, his understanding of it all, is second to none."

Posey nominated Paul's famed audit-the-Fed bill for a "best legislation" award by House Republican freshmen this year. The bill, calling for a government audit of Fed operations, including its monetary policy decisions, won unanimously. Even though a watered-down version was included in the financial regulation law enacted in July, Paul wants to give the audit measure another shot and is counting on a new, high-profile perch to do so. "Traditionally, this subcommittee has been very insignificant," Paul says. "I'm absolutely going to change that." —*Phil Mattingly and Robert Schmidt*

Quoted

"Powerful financial interests, free to throw money about with little transparency, have corrupted the basic principles underlying our representative democracy."
—Christopher Dodd on Nov. 30, in his final floor speech as the U.S. senator from Connecticut



The bottom line *After waiting decades, Fed critic Ron Paul is in line to chair the House's monetary policy subcommittee.*

AP PHOTO (2); BLOOMBERG (11)

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Compensation

What's a Central Banker Worth?

Regardless of how you think he's handled the U.S. recession, Federal Reserve Chairman Ben Bernanke is underpaid compared with his peers. Bernanke, who oversees a fifth of the global economy, is paid less than half what his counterparts in Europe, Japan, Canada, and Ireland get. Even the head of Malta's central bank is paid more. —*Ilan Kolet*

	Central Banker	Country	Salary ($US)*	Nation's share of global GDP
1	Philipp M. Hildebrand	Switzerland	860,455	0.45%
2	Norman Chan	Hong Kong	774,179	0.43%
3	Jean-Claude Trichet	European Central Bank	482,751	20.56%
4	Patrick Honohan	Ireland	359,608	0.25%
5	Mervyn A. King	Britain	473,871	3.07%
6	Masaaki Shirakawa	Japan	472,195	5.96%
7	Mark J. Carney	Canada	441,945	1.84%
8	Michael C. Bonello	Malta	214,192	0.01%
9	**Ben Bernanke**	**U.S.**	**196,700**	**20.42%**
10	Henrique de Campos Meirelles	Brazil	83,185	2.88%



DATA: BLOOMBERG, CENTRAL BANKS AND WEBSITES, IMF, *THE TIMES* OF MALTA * SALARIES ARE FOR 2009 EXCEPT IRELAND AND SWITZERLAND, WHICH ARE 2010

Energy Policy

Green Cars Still Need Training Wheels

- More than half of all hybrid sales are Toyota Priuses
- "It isn't easy to make these vehicles mainstream"

If more than a dozen years of uninspiring hybrid car sales are any predictor, a new generation of even more expensive plug-in electric models now coming on the market, such as **General Motors**' Chevy Volt and **Nissan**'s Leaf, will be a tough sell with consumers.

U.S. sales of hybrids are projected to decline for the third year in 2010, and will account for less than 3 percent of all auto sales. For American automakers, the news gets worse: More than half of all those sales were **Toyota** Priuses, and Uncle Sam bought almost a fourth of the GM and **Ford Motor** hybrids, according to government data obtained by Bloomberg News. "The lesson learned is that it isn't easy to make these vehicles mainstream," says Brett Smith, who specializes in alternative vehicles at the Center for Automotive Research, an independent group in Ann Arbor, Mich. "They are still not near the point where they are cost-competitive in the market."

25%
The U.S. government has bought almost a fourth of GM and Ford hybrids in the last two fiscal years

President Barack Obama has committed more than $11 billion in funds to support the technology and has set a goal of 1 million electric cars on the road by 2015. With hybrids struggling for market share, that target looks daunting.

A traditional hybrid such as the Prius, which starts at about $21,650, uses electric motors and batteries to supplement the gasoline engine and doesn't need to be plugged in. By contrast, Chevy's Volt, expected to fetch $41,000, can drive fully electric for 35 miles at a cost of about $1.50 a day. GM says it aims to sell about 10,000 of the cars through 2011 and 45,000 in 2012. Nissan's Leaf, with a sticker price of $32,780, will run about 73 miles on a single charge, and the company expects to sell as many as 25,000 in the U.S. during the first year. Ford will join the fray late next year with its first all-electric passenger car, a Focus compact.

U.S. sales of hybrids and electric cars are projected to be 2.2 percent of passenger vehicles that will be sold globally this year, J.D. Power and Associates in Troy, Mich., said in an Oct. 27 report. That may rise to 5.2 million units in 2020, the report says. Since **Honda Motor** introduced the first model in 1999, U.S. hybrid sales have totaled about 1.8 million, or



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Chevy Volt



Chevrolet will begin deliveries of the gas-electric Volt compact in December in select cities including San Francisco, New York, and Washington. The Environmental Protection Agency estimates the Volt's electric-only range at 35 miles, after which a gasoline engine provides power for 344 additional miles. The EPA says the plug-in, which General Motors will sell for about $41,000, will get the equivalent of 93 miles per gallon in electric-only mode and 60 mpg in combined gasoline-electric driving (with 33.7 kilowatt hours equaling the energy of a gallon of gasoline.)

Nissan Leaf



Nissan Motor will begin selling the all-electric Leaf hatchback in Arizona, California, Oregon, Tennessee, and Washington State in December. The $32,780 Leaf is expected to run about 73 miles on a single charge, the EPA says. It takes seven hours to fully charge. The window sticker estimates the Leaf will get the equivalent of 99 mpg in combined highway and city driving. The U.S. offers as much as $7,500 in tax credits for the purchase of plug-in vehicles, and about a dozen states offer additional incentives.



Ford Focus



Ford Motor has said that in late 2011 it will introduce a battery-powered Focus compact, its first all-electric passenger car, in 19 U.S. cities, including Atlanta, Chicago, Los Angeles, New York, and Washington. Ford is targeting the range at up to 100 miles; it has not yet released pricing details. Ford also plans to introduce three other hybrid vehicles in 2012 and later this year will sell the Transit Connect, a small, battery-powered commercial van.

about 1 percent of the 175 million vehicles sold in that period.

These cars aren't bargains: Hybrids cost about $3,000 to $5,000 more than a comparable conventional gasoline-fueled car, Smith says. The premium is $10,000 to $20,000 for plug-ins such as the Volt and Leaf, he says. The General Services Administration, which runs the government's fleet, bought at least 14,584 hybrid vehicles in the last two fiscal years, or about 10 percent of total purchases, according to the data obtained by Bloomberg. About 3,100 of the government's hybrids were paid for out of the 2009 economic stimulus package, says Sara Merriam, a GSA spokeswoman. The federal government buys hybrids almost exclusively from U.S. companies, and Merriam says the government's purchases will increase. At some point, carmakers will be forced to confront the question of viability, says Jeff Schuster, director of forecasting at J.D. Power. "For this technology to be accepted," he says, "it needs to be done without a government crutch." —*Angela Greiling Keane and Jeff Green*

The bottom line *As the next generation of plug-in cars comes online, a decline in hybrid sales doesn't bode well for their success.*

Financial Reform

Regulators Hit By Fake Astroturfing

▶ Letters urging tougher derivatives rules are forgeries

▶ "No reason whatsoever to believe that the letters were not authentic"

Political campaigns, public-relations firms, and lobbyists sometimes gin up letter-writing campaigns to create the appearance of grassroots support for their points of view. The practice of astroturfing, as it's known in Washington, backfired on one of its practitioners last month, when letters purportedly signed by small business owners and prominent citizens from Arkansas, asking derivatives regulators for tough rules against financial firms, were found to be forgeries.

Left holding the bag was **Dewey Square Group**, a Boston public-relations firm hired to influence the Commodity Futures Trading Commission. The agency had sought comment on a proposal to limit the ownership of banks and other financial firms in clearinghouses that will process over-the-counter derivatives trades, a proposal that stems from the Dodd-Frank regulatory reform law. Dewey Square says the letters were the work of a subcontractor and didn't know they were fake. Dewey Square would not identify the client for whom the campaign was conducted. **Nasdaq OMX Group** was among the companies that lobbied Congress on the clearinghouse issue. Nasdaq is the majority owner of a swaps clearinghouse; it declined to discuss whether it hired Dewey Square. The CFTC removed the forgeries from its website and referred the case to the Justice Dept.

The letters—purportedly from an **H.J. Heinz** executive, a **Burger King** franchisee, and at least five other Arkansas officials or businesses—were sent to the CFTC in November. Some letters contain identical passages criticizing banks for their "cartel-like control" of the $583 trillion derivatives market. The letters were supposedly signed by an Arkansas circuit court judge, a county sheriff, and a mental health counselor. They all said their signatures had been forged.

Dewey Square principal Ginny Terzano said her firm ran a multistate grassroots advocacy campaign

CLOCKWISE FROM RIGHT: SAUL LOEB/AFP/GETTY IMAGES; TOSHIFUMI KITAMURA/AFP/GETTY IMAGES; BILL PUGLIANO/GETTY IMAGES; KEVORK DJANSEZIAN/GETTY IMAGES; MIGUEL MEDINA/AFP/GETTY IMAGES

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and hired **Goggans**, a Little Rock lobbying firm, to help. The forged letters were sent by a contractor working for Goggans, says Miles Goggans, the firm's founder. He said he was not aware that the letters were forgeries. "I deeply regret what this has done to these Arkansas businesses and individuals, and deeply regret that this inexcusable conduct occurred in the course of work I performed for Dewey Square," said Goggans. In a statement, Terzano said that "Dewey Square had no reason whatsoever to believe that the letters were not authentic and had no knowledge that they were in fact unauthorized until questions were raised in media accounts."

Judge Marilyn Edwards of Washington County, Ark., whose signature was forged, says she spoke to the FBI about the letters. "I'm not a very happy camper about this." —*Silla Brush and Clea Benson*

The bottom line *A so-called astroturf lobbying effort shows much is at stake as regulators write derivatives rules.*

Fiscal Policy

Deficits and Debt As Far As the Eye Can See

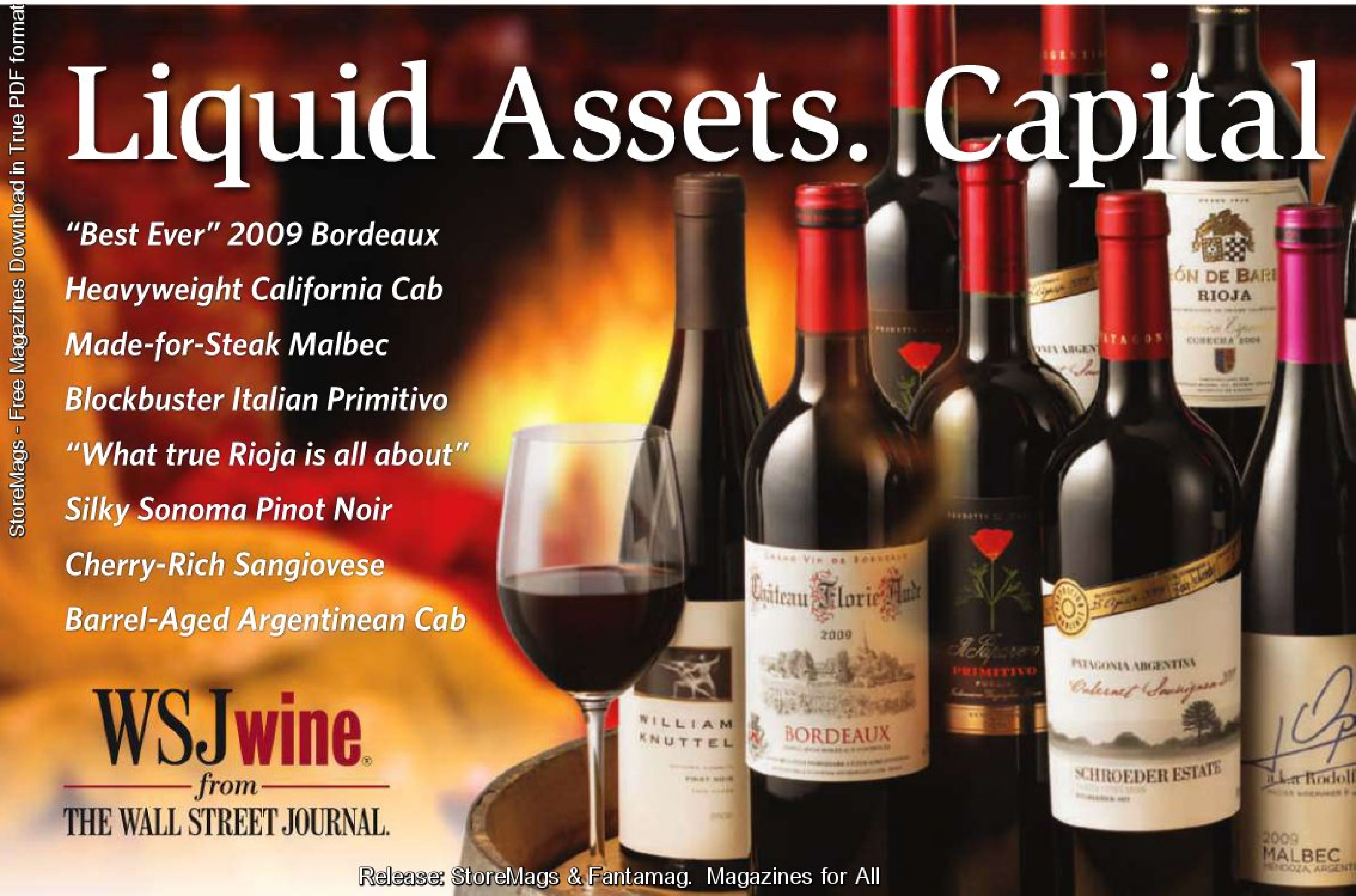
▸ Even Obama's deficit commission takes 25 years to get to balance

▸ "Boomers are showing up old and sick and ... costs are dramatic"

The $3.85 trillion package of spending cuts and tax increases unveiled on Dec. 1 by the leaders of President Barack Obama's deficit-reduction commission is going nowhere legislatively anytime soon. First, 14 out of the 18 panel members must sign off on the proposal, and the prospects of winning that kind of supermajority by a Dec. 3 deadline seemed unlikely as *Bloomberg Businessweek* went to press. Even if that hurdle were somehow passed, the plan would then face a vote in Congress, which shows little appetite for tough choices.

Despite such odds, the report's co-authors, Erskine M. Bowles, former President Bill Clinton's chief of staff, and Alan K. Simpson, a former Republican senator from Wyoming, declared a symbolic victory for focusing attention on the policy choices facing lawmakers if they are serious about making a dent in the $13.7 trillion national debt. Less talked about is that no matter how aggressive the deficit-reduction plan (assuming one surfaces in the next couple of years), the U.S. will face a multidecade effort to get its finances in shape.

The Bowles-Simpson proposal wouldn't wipe out the annual deficit for 25 years. Representative Paul Ryan, a Wisconsin Republican who's in line to chair the House Budget Committee in January and who served on the panel, has his own budget road map that takes a half-century to get to a balanced budget. A separate panel led by former Congressional Budget Office chief Alice M. Rivlin that offered its own scheme last month wouldn't even project a date.



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Finland's Angry Birds strategy page 48 ▶

Bowles and Simpson offer a strict federal diet that would impose spending caps and salary freezes on the federal government. They would cut or do away with tax breaks such as the mortgage interest deduction and put in place lower rates for some individuals and companies. They also recommend cutting Social Security benefits, especially for higher-income retirees, and raising the retirement age to 69 by 2075. Medicare would be cut by more than $400 billion over nine years. Discretionary spending would be cut by $1.67 trillion while mandatory programs would be pared by $556 billion.

And that may not be enough, say deficit hawks. The current demographic and economic environment, they say, make it much harder to find a plausible path to a balanced budget than a decade ago, when stricter fiscal policies, a roaring economy, and lower defense spending after the end of the Cold War produced surpluses.

The nation's debt is forecast to climb to almost 90 percent of GDP by 2020 from 62 percent now

The biggest change is that the first baby boomers became eligible for Social Security in 2008 and will begin participating in Medicare next year. That makes it difficult to scale back the programs because lawmakers want to protect current beneficiaries while giving those approaching retirement time to prepare for changes. "This budget is screwed up so badly you can't balance it in the immediate future," Ryan says. Dick Durbin of Illinois, the Senate's No. 2 Democrat, says the problem is "pure demographics. Boomers are showing up old and sick and, as a consequence, costs are dramatic."

The Obama commission would shrink the deficit to 2.3 percent of the economy by 2015 and more in subsequent years. That would be a major improvement over what budget forecasters say would otherwise happen. The $1.3 trillion deficit for the fiscal year that ended Sept. 30 was 9 percent of the economy, according to the CBO. Debt, meanwhile, is currently forecast to climb to almost 90 percent of gross domestic product by 2020 from 62 percent now, according to the budget office.

If nothing else, the multiple proposals have made budget-cutting a topic of national conversation, even if budgets aren't projected to be balanced for generations—if then. When Republicans take charge of the House in January, political agreement with Obama and the Democratic-controlled Senate over fiscal probity is an unlikely prospect, predicts Stan Collender, a former congressional budget aide. "The mantra for next year is gridlock, stalemate and shutdown," Collender says. Ⓑ *—Heidi Przybyla and Brian Faler*

The bottom line *Neither Obama's deficit commission nor the most hawkish budget-cutters would balance the federal budget for decades to come.*



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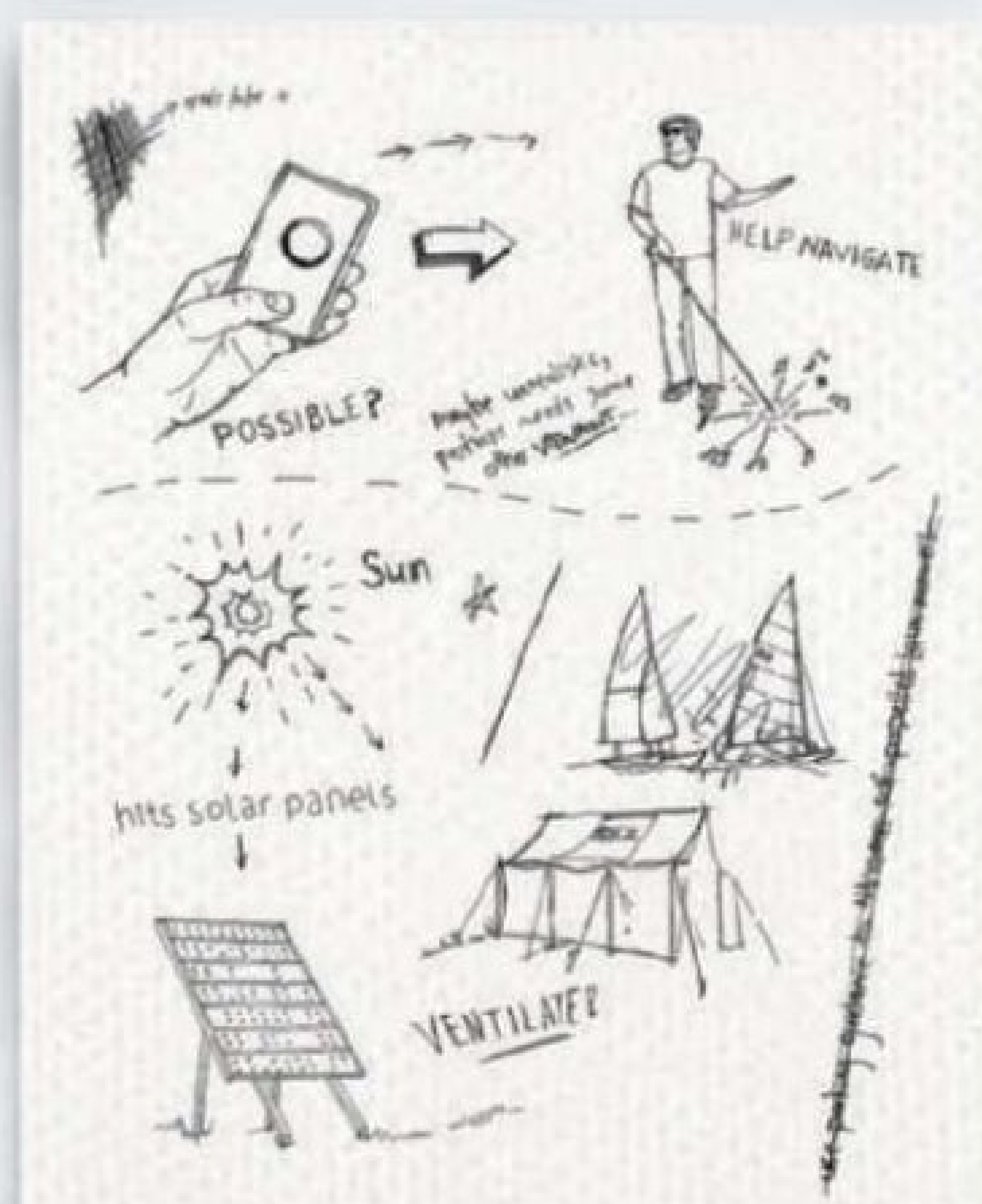
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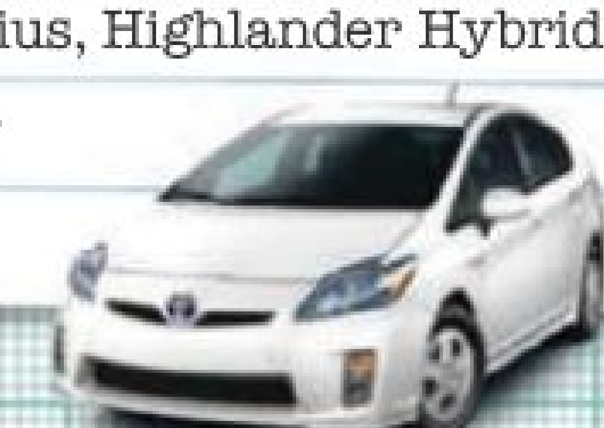
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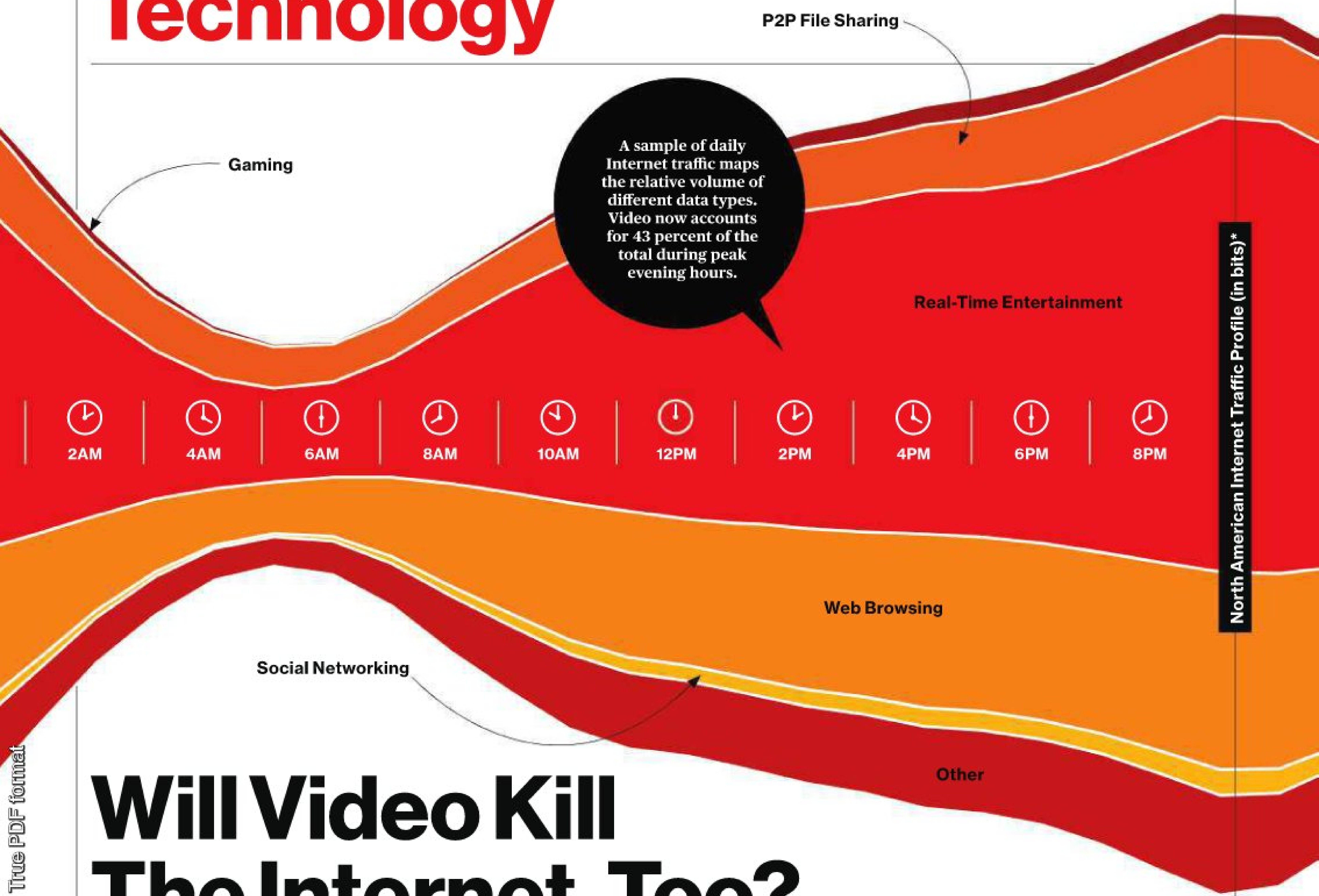
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Technology



*AVERAGE DAILY TRAFFIC IN 2010 AS REPORTED BY DATA PROVIDERS. DATA: SANDVINE

Will Video Kill The Internet, Too?

▶ **Video-delivery and mobile devices are changing the economics of the Internet**

▶ **"It's only a matter of time before the train wreck happens"**

By any measure, **Netflix** is having a really good year. Its subscriber base jumped by 52 percent in the third quarter, and its stock price has doubled since July 1. Analysts and customers are bullish about the Los Gatos (Calif.) company as it moves from a DVD-delivery service to an on-demand entertainment provider and de facto rival to cable TV. Netflix's 16 million subscribers are so eager to stream Sandra Bullock movies—*Crash* and *The Blind Side* are currently the No. 1 and No. 5 most-streamed movies—that the company now accounts for 20 percent of all Internet traffic during the typical American evening, according to **Sandvine**, which makes network monitoring equipment. At the Web 2.0 conference in mid-November, an onstage interviewer asked Netflix Chief Executive Officer Reed Hastings whether the Internet's infrastructure can withstand the strain as his streaming business grows. "If there's anything you'd want to bet on," said Hastings, "it's that technology will make bandwidth faster and cheaper."

That bet may not be as safe as it seems. It's true that history is reassuring, and the steady progression from the dial-up modem to fiber-optic cable has led to bandwidth that easily meets demand. Yet there has been nothing like the double whammy of video and mobile that's under way, say industry executives and analysts. A high-definition movie is magnitudes larger than an e-mail or a Web page, the kinds of content the Net was built to transmit. And there are now more than 50 million smartphone owners in the U.S., many of whom want to catch up on *Glee* while in line at the supermarket.

The most widely cited estimate of Internet traffic, from networking giant **Cisco Systems**, suggests it will triple by 2014, to 64 exabytes a month. (Monthly traffic in 2006 was 5 exabytes, enough to store every word ever spoken.) By then, more than 90 percent of the traffic will be video. "This is the most dramatic change in the network that has ever occurred," says Michael Hatfield, a serial entrepreneur whose latest venture, Cyan Optics, makes gear to

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manage the data flood. Michael Howard, co-founder of market researcher Infonetics, says Cisco's numbers may be conservative. "It's only a matter of time before the train wreck happens," he warns. His worst-case scenario: Carriers halt upgrades, leaving consumers with slow connections and hindering Internet innovation.

The issue is as much about economics as technology. For the same $40 monthly broadband fee, consumers can send 1-kilobyte e-mails—or watch the 30-gigabyte director's cut of a Hollywood thriller on their large-screen PC. Unlike with power or water bills, there's no meter to keep gorgers in check. A study from **Juniper Networks** highlights this "revenue-per-bit" problem. The report predicts that carriers such as **AT&T** and **Comcast** will see Internet revenues grow by 5 percent a year through 2020. Meanwhile, traffic will surge by 27 percent annually, and carriers will need to increase their investments by 20 percent a year to keep up with demand. By this math, the carriers' business models break down in 2014, when the total investment needed exceeds revenue growth. Juniper CEO Kevin Johnson presented these findings at a company event attended by 227 carrier executives. Few of them flinched. "At least half of them said it wouldn't happen in 2014—because it was already happening," he says.

Juniper stands to gain by selling the networking equipment that eases the carriers' pain, so take the company's analysis with a grain of salt. While few experts expect carriers to stop investing in new capacity, there's widespread agreement that a financial crunch is coming. Sanford C. Bernstein analyst Craig Moffett has studied the issue from the perspective of the wireless carriers. As traffic soars, he expects the revenue per megabit to fall from 43¢ today to just 2¢ in 2014. That means a far lower return on investment, a key measure for telecom companies. "The carriers are faced with an incredible deflationary spiral," says Moffett. Stuart Elby, vice-president for network architecture at **Verizon Communications**, says that simply building bigger pipes "feels like a losing battle. I can find ways to build the capacity, but it's hard to justify it if I'm not reaping any benefits in terms of revenue."

The late-November tussle between Comcast and **Level 3 Communications** shows how the issue can quickly become electric. Level 3, which operates backbone networks that quickly ship bits between cities, recently struck a deal with Netflix to help speed delivery of its streaming videos. The result was a sudden surge in Level 3's traffic, which eventually goes through Comcast's cables to reach the company's subscribers. On Nov. 29, Level 3 accused Comcast of charging exorbitant rates to carry the additional traffic. Comcast shot back that it had no obligation to bear the load for free. The exchange is a sign of the times: Even if the technology is up to the task of shipping huge data packets, no one is sure how to pay for it.

Ultimately, most experts expect that the heaviest data consumers will have to start paying more, most likely in the form of tiered pricing plans. These are already common in Europe and Asia, but Americans are used to no limits. The wireless networks have already moved in this direction: In June, AT&T discontinued its all-you-can-eat $30 a month data plan, forcing mobile consumers to choose between two plans that cap usage at 0.2 or 2 gigabytes per month. A Sanford Bernstein survey found that a third of AT&T's customers felt "more negative" about the company as a result of the switch—even though the average subscriber stays well below the 2-gigabyte cap.

On Dec. 1, Federal Communications Commission Chairman Julius Genachowski gave his approval to caps for fixed-line networks that carry data to home or businesses and said carriers should have "meaningful flexibility ... to address the effects of congestion." That might sound like common sense, but it's a blow to advocates of "net neutrality," who believe the carriers shouldn't be able to discriminate against particular kinds of content, such as HD movies.

Such business-model changes are new enough that the big data senders like Netflix haven't yet adapted to them. But on an otherwise triumphant earnings call on October 20, CEO Hastings did concede that AT&T's data cap might limit demand for watching movies on mobiles devices. To Bernstein's Moffett, it was a striking admission. "That was the first time I've heard one of those tech CEOs admit what should be obvious: that you can't simply bet on continued bandwidth availability." —*Peter Burrows*

The bottom line *Video may make up 90 percent of all Internet traffic by 2014—a fact that's changing the economics of delivering data.*

82

Number of domain names seized by the U.S. government on Nov. 29 because of suspected copyright infringement

FROM TOP: MARY EVANS/DREAMWORKS/EVERETT COLLECTION(2); PHOTOGRAPH BY ERIC DRAPER FOR BLOOMBERG BUSINESSWEEK

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Cerelink's servers play roles in the *Kung Fu Panda* and *Shrek* series



Digital Effects

Luring Hollywood To the Cloud

▶ Cerelink's New Mexico processors help DreamWorks make movies

▶ "Films are requiring more and more technology to enable the visuals"

Making a special-effects-laden blockbuster like *Harry Potter and the Deathly Hallows* or an animated hit such as Disney's *Tangled*—the No. 1 and No. 2 movies in the U.S. last weekend—involves complex computing. Sophisticated algorithms govern the way sunlight plays on moving water or how hair moves; transferring that math into an image takes an average of six hours of computing time per frame. And the processing requirements are growing: The original *Shrek*, released by DreamWorks Animation SKG in 2001, required 10 million to 15 million computing hours to complete. This year's *Shrek Forever After* needed 55 million hours.

Cerelink has a pitch for digital studios and special-effects companies: Rather than build, power, and maintain expensive server farms to do all that computing, outsource it. Companies in other data- or computing-intensive fields already rely on off-site servers and connect to that raw horsepower via the Internet—a setup known as cloud computing. "The visual effects industry is, at its core, a technology-centered industry," says James Ellington, Cerelink's chief executive officer. The company allows studios to "expand the production line quickly and flexibly without having to take the time to build more infrastructure," Ellington adds.

In July, DreamWorks Animation became the first studio to sign up with Cerelink. The studio is using its processors in New Mexico to handle some of the computing on the *Shrek* spin-off *Puss in Boots* and a sequel to *Kung Fu Panda*. The deal followed a yearlong trial during which DreamWorks put Cerelink's servers to work on hits including *Shrek Forever After*. "Films are requiring more and more technology to enable the visuals," says Ed Leonard, chief technology officer at DreamWorks. "The advantage of the cloud is that I don't have to build out big data centers on my campus."



Cerelink President Sanchez, CEO Ellington

While Cerelink, which is based in Corrales, N.M., is far from the power-lunch hot spots of Southern California, its location has advantages. One is cheap energy. Leonard says DreamWorks spends more than $100,000 a month powering each of its data centers in San Francisco, Marin County, and Singapore. Cerelink says it pays 9¢ per kilowatt-hour, compared with 14¢ in Los Angeles. For clients that need ultrafast computing, Cerelink also can access New Mexico's Encanto supercomputer, which can perform 172 trillion calculations a second. Because of the nearby University of New Mexico and research centers such as Los Alamos National Laboratory and the Santa Fe Institute, Cerelink can tap a highly educated labor pool to keep its servers humming.

Cerelink started as a consultancy in 2005. One of its four founders, all former Intel executives, had worked in public relations and had extensive government contacts, which helped Cerelink win contracts advising economic development projects in places including Vietnam and Uganda. They soon realized their revenues were too dependent on their clients' ability to get project funding, and by 2008 "we were looking at different business models," says Rod Sanchez, Cerelink's co-founder and president. New Mexico had instituted a 25 percent tax credit for film and television work in 2002 as a way to entice moviemakers. After Cerelink confirmed that the credit would apply to special-effects and animation work, the company transformed into a cloud-services provider for the industry.

DreamWorks will outsource about half of its computing power next year, says Leonard. (A Hewlett-Packard data center in Las Vegas will get some of the business.) Not everyone in Hollywood is as comfortable with the cloud. Richard Kerris, chief technology officer at Lucasfilm, which includes digital-effects powerhouse Industrial Light & Magic, says his clients—mainly big studios such as Warner Bros. and Disney—worry about security. "Whenever a client's content is not in our data

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Miami's Condo King survives the slump
page 53 ▶

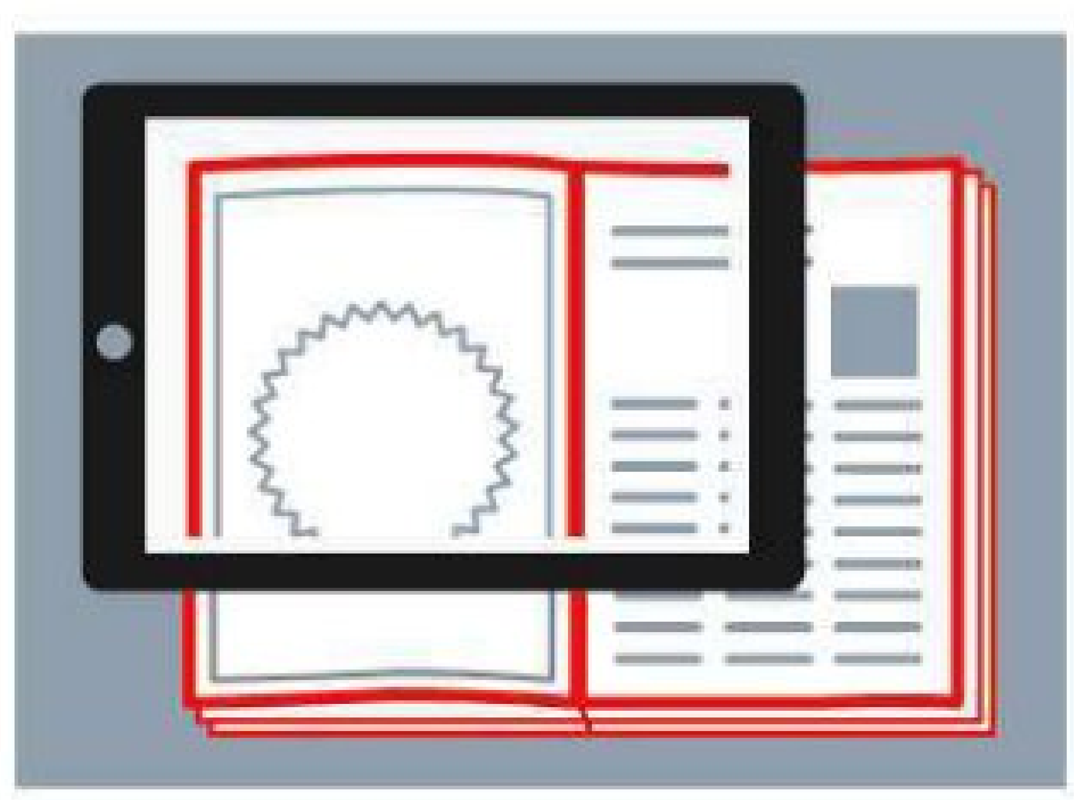
center, there can be concerns," he says. Speed is also an issue. "We move many terabytes of data around," he says. "Sending that to a remote service will demand very high bandwidth transfer rates [that are] just not readily available and/or cost-effective."

Cerelink says its service is secure: It uses dedicated broadband lines to connect with DreamWorks animators, and it isolates the servers running DreamWorks tasks from others in its data center. And the connection is fast enough that an animator in Los Angeles can tweak the shading of a panda's fur, send the command to New Mexico for processing, and have the results register on his screen in less than 20 milliseconds—so speedy that there's no perceptible lag. Leonard says other Hollywood players will inevitably follow DreamWorks' lead. "The guys in the very high end of the business, the Disneys, the Pixars, Weta Digital, all of these guys are keenly interested in using the cloud." —*Michael White*

The bottom line *Cerelink hopes studios and special-effects companies will outsource some of their computing needs to its New Mexico server farm.*

Tablets

Media Dinosaurs Evolve In the iPad Age



▶ Flipboard strikes partnerships with wary publishers for its iPad app

▶ "Everyone looks at it and says, damn, why didn't I do that?"

In July a tiny Palo Alto (Calif.) startup called Flipboard stirred up the tech world with an application for **Apple**'s iPad that promised to change the way Internet users discover and read online news. The app, which is free to download, asks users to enter their Facebook or Twitter account information and favorite publications. Then it pulls in all the relevant links to news articles, blog items, and photographs streaming through those social-networking feeds and displays the content in a visually appealing, easy-to-navigate format evocative of a traditional magazine.

iPad owners and the Internet cognoscenti immediately turned the innovative little program into one of the top-rated free news apps for the iPad. The startup's servers were overloaded for much of its first week.

Despite its fresh approach, Flipboard, like other so-called news aggregators that allow Internet users to collect articles from different sources across the Web and present them in one location, seemed to have the same old attitude toward media company content. It had no agreements with media companies but helped itself to headlines and the first few sentences of a story, then linked to that publication's Web page. Now the startup is changing its approach. As of press time, Flipboard planned to announce on Dec. 2 partnerships with eight media outlets, including *The Washington Post*, **ABC News**, Condé Nast's Bon Appétit, and All Things Digital, a technology blog owned by *The Wall Street Journal*.

Under these deals, Flipboard will be able to present entire articles from those news sources inside its application, without sending readers off to the Web. The company will also begin experimenting with full-screen, magazine-style advertising, which Flipboard hopes will generate big revenues for the media companies—and itself. "We are focused on working with publishers to help them present their content in a way that is much more beautiful and easy to read, and ultimately more monetizable" than their own Web sites, says Mike McCue, Flipboard's chief executive officer. McCue was an early executive at Netscape and the founder of Tellme, a voice-recognition company acquired by **Microsoft** in 2007.

Flipboard, backed by $10.5 million from investors including venture capital firm **Kleiner Perkins Caufield & Byers**, has developed some technological magic to make these arrangements work. Its application takes articles off the media companies' websites and reformats them in a

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visually dynamic Web language called HTML 5, automatically wrapping text around photos, blowing up quotations in big type, and allowing readers to move from one page to the next with the swipe of a finger. Flipboard also strips out all those easily ignored Web ads, which yield little revenue. Instead, it has contracted with **OMD**, a unit of media giant **Omnicom Group**, to insert into each article one or two full-screen ads that aim to evoke the same emotional response as a full-page pitch in a glossy magazine. Although Flipboard's obvious opportunity is to take a slice of these revenues, McCue says it's too early to talk about whether Flipboard or the content companies will ultimately sell these ads—or how revenues will be divided. For now it's all an experiment to see whether the format is successful at getting users to read and share long articles, and to pay more attention to ads.

Media executives have been wary of news aggregators. These tools, like Google Reader, Netvibes.com, and the popular Pulse News Reader for the iPad and iPhone, can send a wave of new visitors to a publication's website. However, over time they can siphon away loyal readers. Executives at companies working with Flipboard express varying degrees of enthusiasm about McCue and his startup. "Flipboard is one of those ideas that everyone looks at and says, damn, why didn't I do that?" says John Boris, an executive vice-president at **Lonely Planet**, the travel publishing company and one of the eight partners. "It makes content that is challenging easily digestible."

Other media companies are focusing efforts on their own iPad apps. Flipboard says it is talking to **Time Inc.**'s *Sports Illustrated*, but the magazine is not yet one of its content partners. And *The Washington Post* is providing only stories from its Sunday magazine, which isn't available in the newspaper's own iPad app. Partnering with Flipboard is, in a sense, a way to hedge bets. "It's an experiment," says Raju Narisetti, managing editor of *The Post*. "It isn't like we have a clear, established road map. Nobody does."

—*Brad Stone*

The bottom line *Flipboard, which makes a news aggregator app for the iPad, is striking partnerships with media companies.*

Entrepreneurs

After Nokia, Can Angry Birds Propel Finland?



▶ **As the handset giant flags, its home country looks to startups for growth**

▶ **"Student stuff is what's going to create the ... companies we need"**

A game featuring egg-stealing pigs under attack by irate birds may not seem like enough to stake a country's economic future on, but it plays a big role in Finland's plans. As the national tech star, **Nokia**, starts to fade, the government is hoping its future prosperity will be brightened by companies such as **Rovio Mobile**, the maker of a hit cell phone game called Angry Birds. The game has been downloaded more than 36 million times for as much as $1 a pop.

Rovio and other startups such as Web micropayment company **APE Payment** could go a long way toward filling the gap left by Nokia, which at its peak accounted for 4 percent of the country's gross domestic product. "We won't get another Nokia," says Risto Siilasmaa, a Nokia board member who founded successful antivirus software house **F-Secure** as a student in 1988. "But we should definitely get 10 or 100 F-Secures and a lot of Angry Birds and APE Payments."

As Nokia has struggled to compete with **Apple**'s iPhone and devices using **Google**'s Android software, analysts estimate the company's profit will shrink to €1.6 billion ($2.1 billion) this year from €7.2 billion in 2007. Nokia's share of Finland's economy slipped to 1.6 percent of GDP last year, according to Helsinki-based economic research institute ETLA.

To help compensate, the government is boosting support for young innovators. The national research funding agency, Tekes, doubled financing for promising ventures, to €30 million a year through 2014. Other programs supply an additional €30 million to support startups.

This year the government sponsored a "Summer of Startups" at Aalto University, the nation's flagship technology campus just down the road from Nokia's headquarters. Ten teams of young entrepreneurs attended the two-month event, participating in workshops and other activities designed to help them build stronger companies. "This grassroots student stuff is what's going to create the 10 to 20 companies we need," says Will Cardwell, who directs the university's Center for Entrepreneurship.

Attending the camp were Timo Herttua, 23, and Tuomo Riekki, 22, co-founders of a sales-force software company called **Deal Machine**. The two, who met while serving in Finland's army, had each set up Web design businesses as teenagers. Launched this year, Deal Machine now has nearly 600 customers. The duo received a €30,000 grant from Tekes to develop their company.

Finland hasn't always given startups a warm embrace. High taxes, a lack of incentives for investors, and the country's distance from major markets have prompted entrepreneurs to leave or sell out to bigger firms. The founders of Jaiku, a micro-blog site like **Twitter**, sold their company to Google in 2007, and the following year database company MySQL was bought by Sun Microsystems. Linus Torvalds, the Finn ➔

Quoted

"What's going on in the Internet is tremendously exciting, too. We can walk and chew gum at the same time."
—Kleiner Perkins Caufield & Byers partner John Doerr, in response to comments that his firm is turning away from cleantech investing



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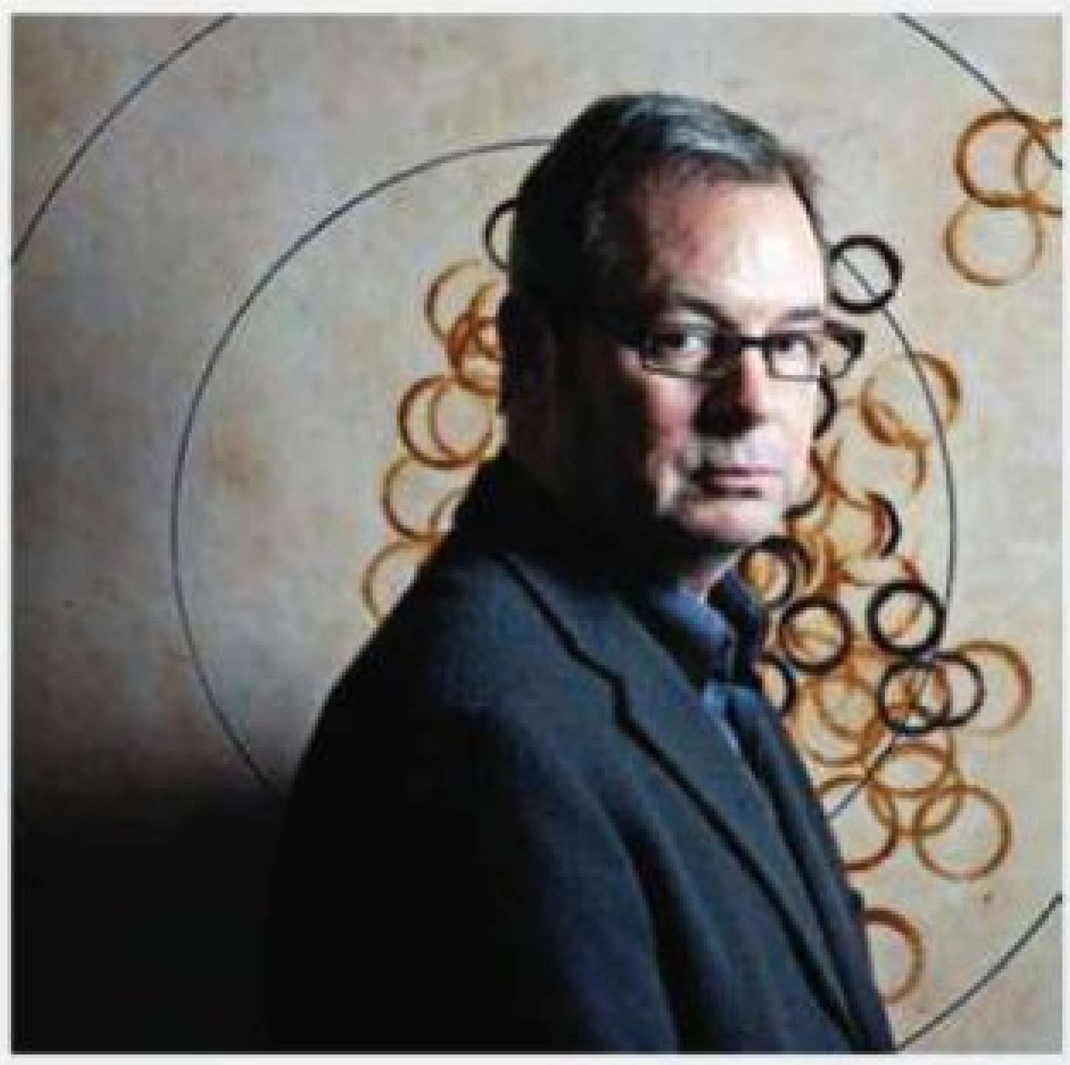


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Innovator

Richard Huganir



The Johns Hopkins neuroscientist says his research could lead to a drug that helps people forget painful experiences

Dr. Richard Huganir, the 57-year-old director of Johns Hopkins University's Neuroscience Dept., has spent more than 30 years researching how memories form. His recent discoveries may pave the way for a drug that selectively erases them.

Huganir and his postdoctoral fellow, Roger Clem, have been investigating calcium-permeable AMPARs, protein molecules that appear in the brain for about 48 hours after a person experiences a traumatic event. Scientists previously considered them unimportant to memory formation, but Huganir and Clem thought otherwise. Over the past two years they administered electric shocks to a group of about 100 mice while simultaneously playing a tone. They also administered a drug to some of the mice that kept their brains flooded with AMPARs. Those mice retained fearful memories of the sound long after the initial jolt, while the drug-free group gradually became inured to it, essentially forgetting its link to the painful experience. The experiment proved that the proteins are essential to building the brain circuitry that forms a memory, and to recalling the memory later. "It's a huge step forward," says Joseph E. LeDoux, a professor at New York University and an authority on memory and emotions.

Huganir and Clem are now experimenting with a drug that removes AMPARs and could prevent memories from forming in the first place. They hope to publish the results next year, and Huganir says that in as little as a decade the research could lead to drugs that help people forget painful experiences. Blocking AMPARs won't erase the entire memory of an event, says Huganir, but it would eliminate the strong emotions attached to it. That could be a game-changer for the nearly 8 million American adults with post-traumatic stress disorder. Huganir says he regularly gets e-mails from PTSD sufferers asking to be part of human drug trials if and when he holds them. His research may also lead to drugs that aid memory retention by stimulating AMPARs, a potential boon for test takers and Alzheimer's patients.

Huganir began his first, informal neuroscience studies while in high school in Philadelphia. He owned 10 goldfish and tested them for intelligence by observing their reactions to sudden flashes of light. "I sacrificed the smart one and ground up its brain and injected it into the brain of another," says Huganir. "He seemed fine, but he wasn't smarter." After earning his PhD at Cornell University, he first focused his research on how muscles respond to signals from the brain.

Huganir's recent work recalls the 2004 movie *Eternal Sunshine of the Spotless Mind*, in which two characters erase memories of their failed relationship. Will real-life ex-lovers soon be able to do the same? "No," Huganir says. "That's science fiction." —*Olga Kharif*

Early Lab Work ▶ Experimented on goldfish in high school

Discovery ▶ That a short-lived protein is essential to memory formation

Future ▶ A drug that could help PTSD sufferers forget traumas

Technology

who fathered the Linux open-source software movement as a student, moved to California in 1997. The Deal Machine founders plan to move to Silicon Valley next year to get closer to other techies and funding. "Young entrepreneurs need to go learn from the best in the world," says Kristo Ovaska, 27, who in October led a group of startups to Silicon Valley, where they practiced pitching their projects.

Finnish startups are hobbled by a lack of venture funding. **Fruugo**, which started a multinational European shopping website in 2009, got less than half the capital it had hoped for in Finland and in September merged with Britain's **Directory Technologies**. Finnish high-tech companies raised about €50 million in venture capital in the first half of 2010, according to **Technopolis**, a firm that incubates tech companies and helps them find funding. The Israel Venture Capital Research Center says Israeli companies received $577 million. "There are only a handful of venture capitalists in Finland, and to get the attention of foreign venture capitalists has been quite challenging," says Rovio Chief Executive Officer Mikael Hed.

He acknowledges that Rovio has been luckier than most. The founders, who met at a hacking contest in 2003, received backing from family members. The company will celebrate the first anniversary of Angry Birds on Dec. 10 and is branching out into ancillary products such as stuffed birds and pigs. The 30-plus employees are rolling out special editions of the game for the holiday season as well as versions for game consoles and **Facebook**.

Rovio's experience illustrates how Finnish tech companies are being weaned from a dependence on Nokia. In its early days the company produced many games for Nokia devices, but it was the iPhone that gave wing to its biggest hit. "Angry Birds is the perfect example of the challenge that has faced Finland in the last five years," says Ben Holmes, a partner at Geneva venture capital firm **Index Ventures**. After making little progress with games for Nokia handsets, "along comes iPhone and they have that breakaway success." Ⓑ
—*Diana ben-Aaron*

The bottom line *With national champion Nokia in decline, Finland is counting on a new wave of tech startups to power economic growth.*

PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK

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Markets&Finance



Pérez says he will get financing for high-rises when the market recovers

ELIOT J. SCHECHTER/BLOOMBERG

Miami's Condo King Survives the Slump

▶ **Jorge Pérez, one of Florida's biggest builders, made deals with his lenders and is investing again**

▶ **"You're here on a loan, and you never know when they're going to call it"**

Early this year, as Jorge M. Pérez struggled to restructure more than $1.5 billion of debt on mostly vacant Florida condominium projects, doctors discovered a tumor the size of a golf ball on his pancreas. "You understand how vulnerable you are," Pérez, 61, says while sitting in his Miami waterfront office, with a view of the skyline shaped by **Related Group of Florida**, the real estate company he helped launch in 1979. "You're here on a loan, and you never know when they're going to call it."

Pérez, known locally as the Condo King, survived the medical scare. In January, following nine hours of surgery, doctors determined the tumor was benign. After absorbing $1 billion in losses, Related Group has survived, too. On Nov. 16 the company reached a foreclosure agreement with lenders holding a $223 million mortgage on Trump Hollywood, a 41-floor luxury-condo tower in Hollywood, Fla., where 22 of 200 units have sold. The deal put the last of Pérez's seven troubled Sunshine State projects behind him. Related Group lost four of the seven Florida developments to foreclosure, sold its interest in one to a partner, and renegotiated payments on two others. In all but one case, it retained a management or marketing role in the property.

"He's one of the faces of the boom-bust cycle that resulted in the great recession," says Jack McCabe, a real estate consultant in Deerfield Beach, Fla. "He's also one of the real geniuses, because he's been able to stay in business."

As a boy of 10, Pérez fled Cuba with his family after the 1959 revolution. The family lost everything they owned. Pérez remembers watching soldiers at the airport take his mother's jewels, including the rings on her fingers. He finished high school in Colombia, then moved to Miami to start community college, eventually earning a

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master's degree in urban planning at the University of Michigan in 1976. After graduate school, he returned to work for the City of Miami Planning Dept., followed by a job at Landauer Associates, a real estate services firm. In 1979, when Pérez was scouting for low-cost housing deals, he competed against a New Yorker named Stephen Ross, founder of Related Cos.

"A woman working for the City of Miami said, 'You guys should get together,'" Ross, 70, recalls. "We both had the same passion." Ross, whose company's real estate portfolio is worth more than $15 billion, says he offered Pérez 15 percent equity in Related's Florida division, which became Related Group. Over time, Pérez's share climbed to 75 percent. Ross says he holds the other 25 percent in the company, which built or manages more than 77,000 housing units in the U.S. and Latin America, and was responsible for 5,500 of the 22,000 condos that sprouted in Miami's central business district from 2003 to 2008. Pérez is also a vice-chairman of the Ross-owned Miami Dolphins of the National Football League and attends home games in the owner's box.

Now, Related is investing again. Pérez says he's using government financing to build affordable housing in Florida's Miami-Dade and Orange counties. Earlier this year he bought shopping malls in Phoenix and Birmingham, Ala. He returned Nov. 18 from India, where he's an investor in a partnership to build middle-class housing.

The median price of a Miami condo is down 58 percent over the past five years, according to Florida Association of Realtors data. To survive the real estate crash, Related Group has cut 300 of 600 employees since 2008. And unlike many developers, Pérez confronted his troubled projects while he still had some negotiating leverage, says Troy Taylor, president of **Algon Group**, an Atlanta investment bank that advised Pérez on restructuring. Related Group recognized $1 billion in losses in 2008 after buyers couldn't get financing or didn't want to pay for condos they had put deposits on, says Matthew J. Allen, its chief operating officer. In January 2009, the company invited representatives from seven loan syndicates to a conference room at the Hilton Miami Downtown, where Pérez presented a plan for a comprehensive workout. "I had 80 lenders, from all over the world, and each one of them could say no," Pérez says.

Each one did say no, at first. Ultimately, Pérez negotiated deals with all seven syndicates. In May, for example, an **HSBC**-led group with a $482 million construction note repossessed two towers of the Icon Brickell in Miami, allowing Pérez to keep a hand in the building's management. In October, Pérez negotiated a forbearance agreement with a **Bank of America**-led syndicate on a $175 million loan for the Icon's third tower, which also houses a Viceroy hotel. The agreement allows him to stretch out payments and cut prices to speed sales. The Trump Hollywood foreclosure came last month, when an HSBC-led syndicate sold its $223 million mortgage to **BH III**, a closely held Miami-based investment firm, for $160 million.

For now, Related's projects are much more modest than previous efforts. "We're increasing the size of the management company, being advisers to other people in real estate, and doing things that allow us to survive and, hopefully, prosper," Pérez says.

Yet he hasn't given up on his dream of a tropical Manhattan. He owns sites on Las Olas Boulevard in downtown Fort Lauderdale and off Brickell Avenue in Miami where he has plans for more high-rise condos, though he expects it will be at least three years before he can launch those projects: "If you went to a lender and asked for financing on a condo, they'd either laugh so hard that they'd die or they'd shoot you right on the spot." When the market does perk up, he believes he'll be able to get financing, because he treated investors and lenders fairly during the worst real estate bust in his life. "We never walked away from anything," he says. "Now we're debt free. We're a very strong company." —*John Gittelsohn*

The bottom line *By negotiating deals with his lenders, Pérez stayed in business and is in a position to build big again when Miami's market revives.*

SANJIT DAS/PANOS

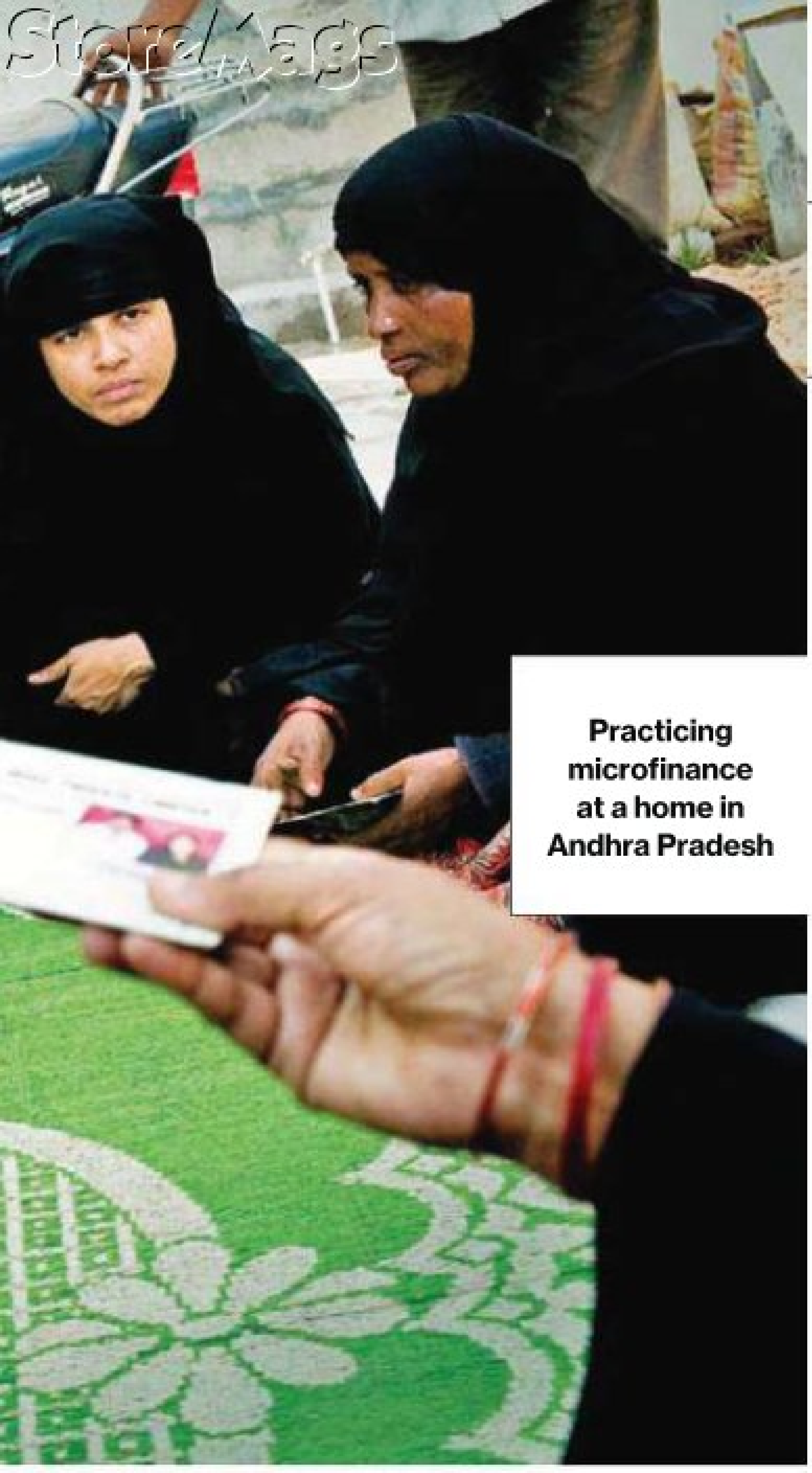
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"If I were betting even odds, I'd bet that [house prices] bounce along the bottom. If you gave me 2-to-1 odds, I'd bet they go down."
—Karl E. Case, co-creator of the S&P/Case-Shiller Index. The 20-city index dropped 0.8 percent in September, the biggest monthly decline since April 2009.



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Practicing microfinance at a home in Andhra Pradesh

Microfinance

Private Equity's Indian Dilemma

▸ New rules hit microlenders and their big investors—hard

▸ "You have to be very courageous or mad to invest" in the sector now

The Indian state of Andhra Pradesh unsettled the world of microfinance in mid-October when it passed rules regulating debt-collection techniques and prompted some microlenders to agree to a target 24 percent cap on interest rates. On Nov. 23, India's Finance Ministry said it would introduce legislation that would also increase oversight of the industry and seek to eliminate such practices as forcing borrowers in danger of defaulting to take out additional loans and the seizure of household goods by debt collectors.

Since then the profit outlook for microlenders in India, the world's largest market for this sort of finance, has worsened. The credit ratings of a dozen local companies, including **SKS Microfinance** and **Equitas Micro Finance India**, may be downgraded over worries about their future profitability, the Indian unit of Standard & Poor's, Crisil, said on Nov. 22.

The shifting regulatory climate in India's 240 billion-rupee ($5.3 billion) microfinance market may be bad news for private equity and venture capital investors that have steered $565 million into Indian microlenders since 2006, according to financial research firm Venture Intelligence.

Until now, major global investors were making substantial profits. In August, SKS, India's biggest microlender, raised 16.3 billion rupees in an initial public offering. That share sale also generated a capital gain of 5 billion rupees for investors such as Silicon Valley private equity firm **Sequoia Capital** and Bangalore-based fund **Unitus Capital**, which sold part of their stakes, according to data compiled by Bloomberg. "Today nobody wants to invest in the sector because of the uncertainty over regulation," says Sumir Chadha, managing director of Sequoia Capital India.

In November, **Share Microfin**, which is backed by Dubai private equity fund **Legatum**, and **Spandana Sphoorty Financial**, whose investors include Singapore sovereign wealth fund **Temasek Holdings**, said they would delay IPOs that were expected in the first half of 2011 because of the new restrictions. "If all the big guys are facing the risk of not being around, you have to be very courageous or mad to invest," says Vineet Rai, founder of **Aavishkaar Venture Management Services**, a microfinance investor in Mumbai.

The practice of focusing on loans in poor areas largely shut out from traditional banking services gained prominence globally when Muhammad Yunus won the Nobel Peace Prize in 2006 for his role in founding Bangladesh's **Grameen Bank**. Microlending in India has expanded at an average annual rate of 62 percent over the past five years in terms of number of customers and 88 percent in loan volume, according to Micro-Credit Ratings International, a rating firm in Gurgaon, India.

The tougher regulations in Andhra Pradesh, a southern state that accounts for 30 percent of India's microlending market, arose from concerns about overlending to low-income borrowers, interest rates as high as 50 percent, and coercive debt-collection techniques that the state government claims have led to impoverishment and suicides by borrowers. There were 9.6 loan accounts for every poor household in the state, according to a report released on Nov. 15 by the nonprofit group Access Development Services. The upshot? "I don't think private equity investors will recover their money at the rates they thought they would," says Sanjay Sinha, managing director of Micro-Credit Ratings International.

—*Ruth David*

The bottom line *A regulatory backlash against Indian microlenders is complicating the exit strategies of private equity and venture capital investors.*

Secondary Markets

A Way for Outsiders To Bet on Facebook

▸ Specialty firms bundle shares to make them more widely available

▸ "People want to invest, and we provide a means for them"

Facebook's surging value is spurring shareholders of the company, which is not publicly traded, to sell some of their stock, giving investors from Silicon Valley to Wall Street a chance to share in the social network's fortunes. **EB Exchange Funds**, based in San Francisco, along with New York firms **Felix Investments** and **GreenCrest Capital**, have opened Facebook funds. "I don't necessarily know if it's a good investment," says Laurence Albukerk, founder of EB Exchange Funds. "I just know people want to invest, and we provide a means for them to do that."

$40.7 BILLION

Facebook's value according to SharesPost, a secondary exchange

Outsiders who want to buy into a private company can try a secondary exchange such as **SecondMarket** or **SharesPost**. There's no guarantee that the shares will be available, and companies generally have the right to block the sale by purchasing the shares themselves. Firms such as EB Exchange are potentially creating a new class of assets that would let investors tap fast-growing private compa-

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Playing with fire to reduce risk page 64 ▶

nies like **Twitter**, **Zynga**, and **LinkedIn**. They buy shares in private companies from employees or company backers, placing the shares in limited-liability companies. Investors can then buy units in those companies. Felix Investments opened its first fund more than a year ago and now has funds for 14 companies, including Facebook, Twitter, Zynga, and LinkedIn.

Facebook, with a half-billion users, has more than tripled in value since March, to $40.7 billion, according to SharesPost, which looks at recent transactions and analysts' estimates. Zynga, the creator of online games such as FarmVille and FrontierVille, is valued at $5.4 billion, and social-networking service Twitter is at $3.4 billion. SharesPost values professional-networking site LinkedIn at $2 billion.

EB Exchange is buying as much as $15 million in Facebook shares for a limited-liability company, according to a Nov. 1 letter to prospective shareholders. The letter says that units in the LLC cost $10,000, with a minimum investment of $100,000. EB Exchange makes money by charging a 5 percent fee to enter the LLC–called **Zoom Ventures**–and another 5 percent when Facebook shares are distributed after an initial public offering or acquisition. An LLC can have no more than 99 participants, who must be what the Securities and Exchange Commission calls "accredited investors"–generally, companies or affluent individuals. While Albukerk confirms that he created the LLC, he declines to comment on whether it's investing in Facebook, citing regulatory restrictions that limit what he can say.

Boaz Rahav, an 18-year veteran of the financial industry, founded GreenCrest in New York earlier this year after talking to institutional investors who were having trouble investing in Facebook. He expects to raise at least $100 million for his Facebook fund. "There are quite a large number of institutions, large and small, that missed the boat or missed the opportunity to invest in Facebook," says Rahav. Both Albukerk and Rahav say they expect to open multiple company-specific LLCs.

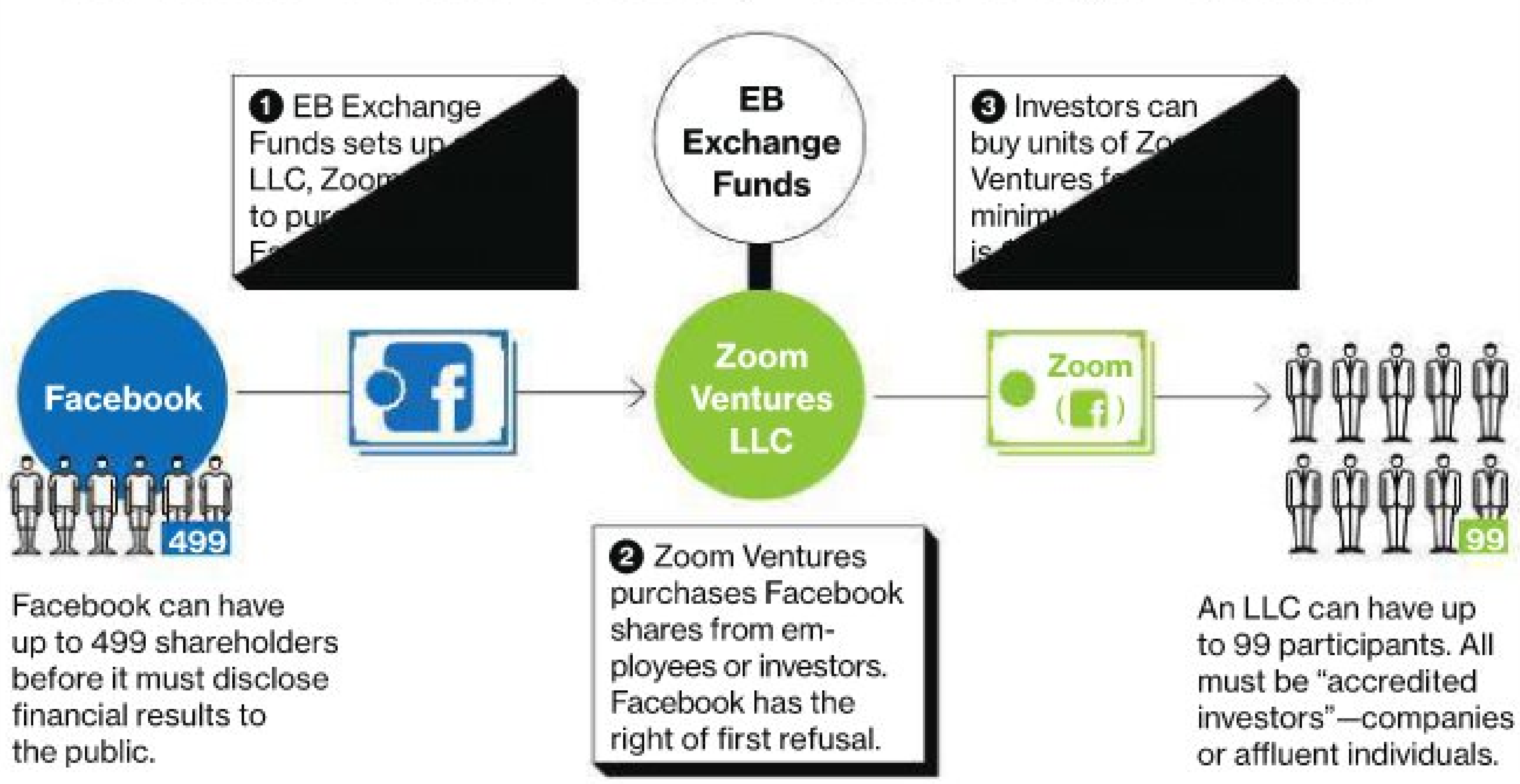
For Facebook, the secondary market has made it easier for employees and investors to sell shares, easing pressure on the company to go public. Facebook is likely to put off its IPO until 2012, three people familiar with the matter said in July. Facebook spokesman Jonathan Thaw declined to comment.

Alex Bernstein, a San Francisco investor, bought a stake in EB Exchange's fund. While he says he's optimistic that Facebook's value will continue to rise, he recognizes the risk of investing in a security that will be difficult to sell until the company has an IPO. "It's an unproven path to liquidity," says Bernstein. "Secondary markets play a meaningful role for a period of time. We still need an IPO window to get liquid."
—Ari Levy

The bottom line *Investment firms are buying Facebook shares from insiders and repackaging them so outsiders can own a piece of the company.*

Friending a Private Company

EB Exchange is among the firms setting up investment vehicles to allow outside investors to bet on the future of Facebook, whose stock is not publicly traded.



Facebook can have up to 499 shareholders before it must disclose financial results to the public.

An LLC can have up to 99 participants. All must be "accredited investors"—companies or affluent individuals.

DATA: BLOOMBERG

5.09

PERCENT

The gain in the Dollar Index for November, topping stocks, bonds, and commodities and confounding those who said Federal Reserve policies would debase the currency.

DATA: BLOOMBERG

Investigations

Giving Investors an Information Edge

▶ Expert networks are under scrutiny in a broad insider trading probe

▶ "My contacts are the foot soldiers and the worker bees"

The federal government's recent raids of high-profile hedge funds, part of an insider-trading investigation, have focused attention on firms known as expert networks. The firms act as matchmakers, connecting investors with people who have extensive knowledge of countries, industries, and companies and who can provide information on product development, sales, and strategy.

"My contacts are the foot soldiers and the worker bees of the industry," says John Kinnucan, who runs **Broadband Research**, specializing in tech companies, from his home in Portland, Ore. Several firms he says are his clients, including Steven A. Cohen's **SAC Capital Advisors**, **Wellington Management**, and **Janus Capital Group**, have been asked for documents as part of the federal probe. Janus says it is cooperating with the inquiry. Spokesmen for SAC and Wellington declined to comment.

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Insider trading involves buying or selling stock using significant non-public information. The current investigation is being conducted by the office of U.S. Attorney Preet Bharara in Manhattan. Two hedge funds, **Level Global Investors** and **Diamondback Capital Management**, were searched by FBI agents on Nov. 22. Both firms were founded by former employees of SAC Capital Advisors. A third hedge fund, **Loch Capital Management**, was also searched by FBI agents. None of those firms have been accused of wrongdoing. Diamondback says the raid focused on one of its employees, who was put on leave. A Level Global spokesman says the firm is cooperating with the investigation. A Loch spokesman did not return a call seeking comment. Kinnucan, who hasn't been accused of wrongdoing, says there is nothing inappropriate about his research.

On Nov. 24, a consultant to hedge funds, Don Ching Trang Chu, was charged with arranging for insiders at publicly traded companies to provide information improperly to clients of his firm. Chu worked as the Taiwan liaison for **Primary Global Research**. Mountain View (Calif.)-based Primary Global said in a statement that it "has severed its relationship with Mr. Chu" because of "recent events." Chu's lawyer, James DeVita, declined to comment.

Primary Global Research did work for **Spherix Capital**, a hedge fund where Richard Choo-Beng Lee used secret tips to trade stocks, according to his guilty plea. Lee helped the FBI tape Chu as part of a U.S. probe of insider trading at Galleon Group, whose co-founder, Raj Rajaratnam, was indicted a year ago and faces trial next month. Rajaratnam denies wrongdoing.



Cohen's SAC Capital has been asked to provide documents

The FBI has also questioned a consultant who worked for expert network Gerson Lehrman, according to *The Wall Street Journal*. A spokesman for the firm declined to comment. The firm has a marketing relationship with Bloomberg LP, parent of *Bloomberg Businessweek*.

Geoff Bobroff, a fund consultant in East Greenwich, R.I., who is part of Gerson Lehrman's network, says the use of experts has risen in response to the decline of Wall Street research after 10 firms collectively paid $1.4 billion in 2003 to settle claims they slanted their research to win banking business.

Michael W. Mayhew, chairman of Integrity Research Associates in New York, estimates that the roughly 40 expert networks in the U.S.—up from 8 in 2001—took in a total of $450 million to $500 million in revenue in the past year. Gerson Lehrman, based in New York, operates the largest network and has 60 percent of the market, according to Mayhew.

Burton Greenwald, an independent fund-industry consultant in Philadelphia, is part of three networks, including Gerson Lehrman's, usually providing hedge fund managers with information and his analysis of investment-management companies. "I've found the networks make an honest and vigorous effort to make sure non-public information is not disclosed to the clients who use their services," he says. "I have to sign an agreement with Gerson that I won't talk about anyone who is my employer or about non-public information."

Greenwald says the networks that arrange phone calls between experts and investors don't monitor them, and, theoretically, investors could use them to seek insider information. "The top-tier hedge funds may not do this," he says. "But I think when you get down to lesser players, you're in the Wild West."
—Christopher Condon, Anthony Effinger, Sree Bhaktavatsalam, Bob Van Voris, and Patricia Hurtado

The bottom line *An investigation into expert networks is raising questions about the line between providing information legally and insider trading.*



The 162-room St. Regis Lhasa opened in November

Commercial Real Estate

Luxury Hotels Reach New Heights in China

▶ A five-star spa comes to Tibet with the St. Regis Lhasa

▶ It "isn't necessarily the first location that comes to mind..."

A hotel glut in China's big cities is spurring luxury chains to explore some remote locations. In November, Lhasa, the capital of Tibet, got its first international luxury hotel with the opening of the 162-room St. Regis Lhasa Resort, featuring a five-star spa. In 2012, **Shangri-La Asia** will open a 350-room hotel in Lhasa, and **InterContinental Hotels Group** plans to add a high-end, 2,000-room hotel in the city within three years.

Visitors to Shangri-La's Lhasa hotel will be able to experience Tibetan welcome rituals and the local hand-churned butter tea, which is believed to be beneficial at high altitudes and prevent chapped lips. The property will feature a full-service clinic to attend to guests who suffer from altitude sickness. Tibet is the highest region on Earth, with an average elevation of 16,000 feet; Lhasa is at 12,000 feet. "Luxury today is not about champagne and caviar but about experiencing something your neighbor hasn't," says Jonas Ogren, a Singapore-based director for STR Global, an industry research company. "It's about experiencing champagne and caviar at Everest Base Camp."

The surge of hotel development in China has led to an oversupply,

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particularly in cities, and it may take five years for demand to catch up, says Ogren. "There was something like 52 new hotels opening up for the Olympics in Beijing," says Dave Horton, global head of Hilton Hotels & Resorts. "They went from 100 percent occupancy during the Olympics to 20 to 30 percent occupancy now."

5.56
MILLION

The number of tourists visiting Tibet in 2009, up 147 percent from 2008

That's made Tibet and other regions far from Beijing and Shanghai increasingly attractive to expanding hoteliers. "While Tibet isn't necessarily the first location that comes to mind for a hotel, these companies usually already have properties in primary and secondary cities," Ogren says.

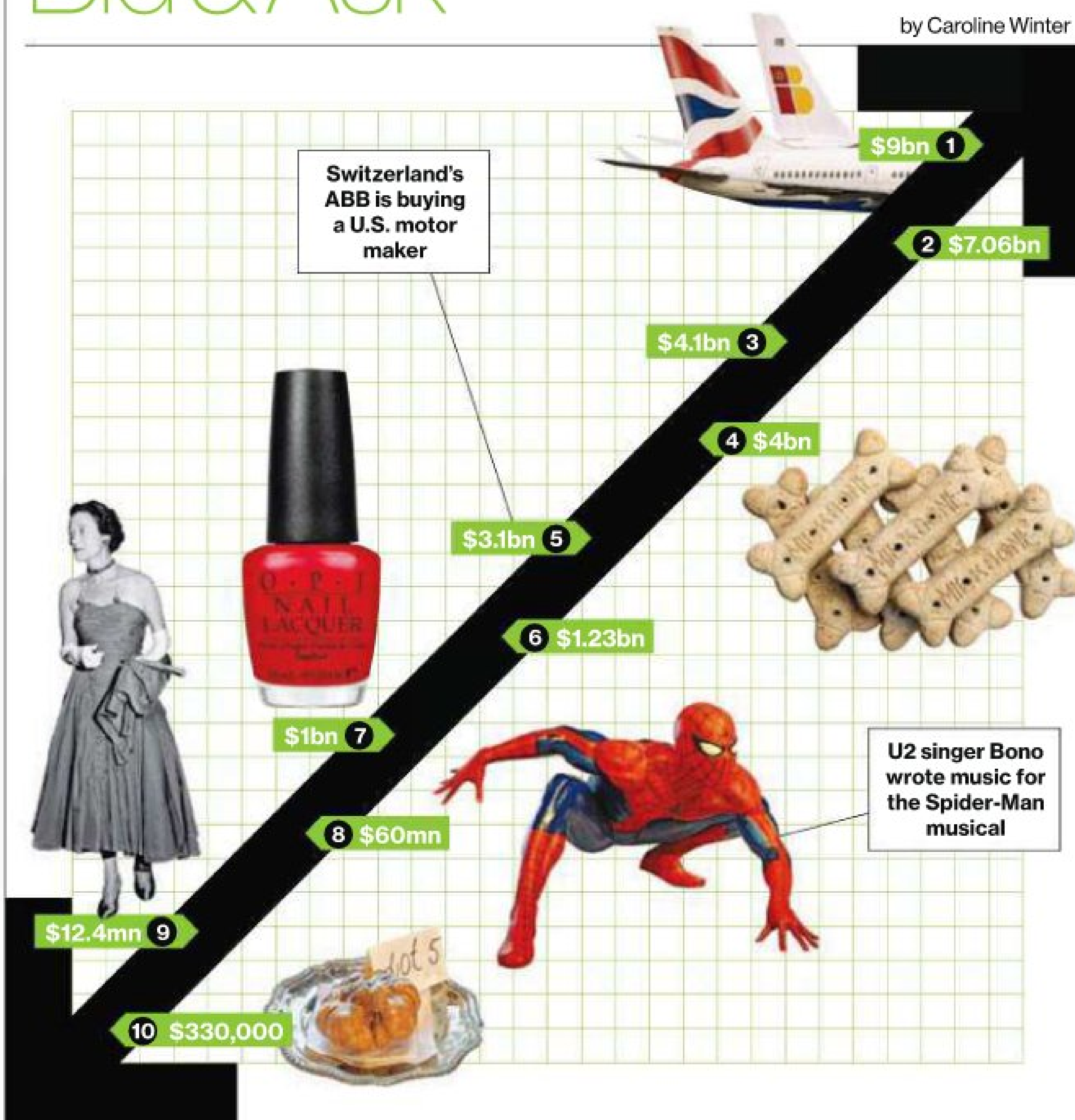
In Tibet, ruled as an autonomous region in the People's Republic of China, tourism has surged since the opening of the Qinghai-Tibet railway four years ago, largely driven by domestic demand. Tourism grew 147 percent in 2009, according to the Pacific Asia Travel Assn., and 5.39 million of the 5.56 million visitors to Tibet were domestic travelers. "There's a great deal of affluence in China," says Judy Reeves, a spokesman for Shangri-La Asia, based in Hong Kong. "The demand for luxury is insatiable." ShangriLa has 33 hotels in China and 15 more in the pipeline, in such remote regions as Diqing in Yunnan province in the country's south and Manzhouli in the Hulunbuir grasslands in northern China.

Starwood Hotels & Resorts Worldwide, which partnered with Lhasa Yungao International Hotel in developing the St. Regis in Lhasa, expects to add 86 hotels to the 62 it has in China, making the country its largest hotel market after the U.S. The hotelier, based in White Plains, N.Y., already has a 102-room Four Points by Sheraton in Lhasa. IHG, of Denham, England, operates 137 hotels in China and has 149 more planned, the company said in June.
—*Nadja Brandt*

The bottom line *With a glut of lodging in China's big cities, hotel developers are targeting resort areas and remote locations for new properties.*

Bid & Ask

by Caroline Winter



1 Shareholders of **British Airways** and **Iberia Líneas Aéreas de España** gave the go-ahead for a $9 billion merger that will extend the U.K. company's dominance of trans-Atlantic routes.

2 **Bridas**, the oil company owned by Chinese crude producer CNOOC and Argentina's billionaire Bulgheroni family, agreed to pay BP $7.06 billion for the 60 percent of Pan American Energy it doesn't already own.

3 U.S. buyout fund Lone Star is selling its 51 percent stake in Korea Exchange Bank to Seoul-based **Hana Financial Group** for $4.1 billion.

4 A **KKR**-led group agreed to acquire Del Monte Foods in a $4 billion transaction that will give the buyout firm popular pet-food brands like Milk-Bone.

5 **ABB**, the Swiss maker of factory robots and power-transmission gear, will buy Baldor Electric for about $3.1 billion to expand in the North American market for industrial motors and drives.

6 **China Huaneng Group**, that nation's biggest electricity producer, is paying $1.23 billion for a 50 percent stake in Massachusetts-based power utility InterGen—its biggest overseas acquisition in more than two years.

7 **Coty**, the seller of perfumes by Sarah Jessica Parker and Vera Wang, agreed to pay $1 billion for nail-care company OPI Products, which gives it entrée into the professional salon market.

8 *Spider-Man*, the most expensive Broadway musical in history at $60 million, held its first preview at New York's **Foxwoods Theater** on Nov. 28.

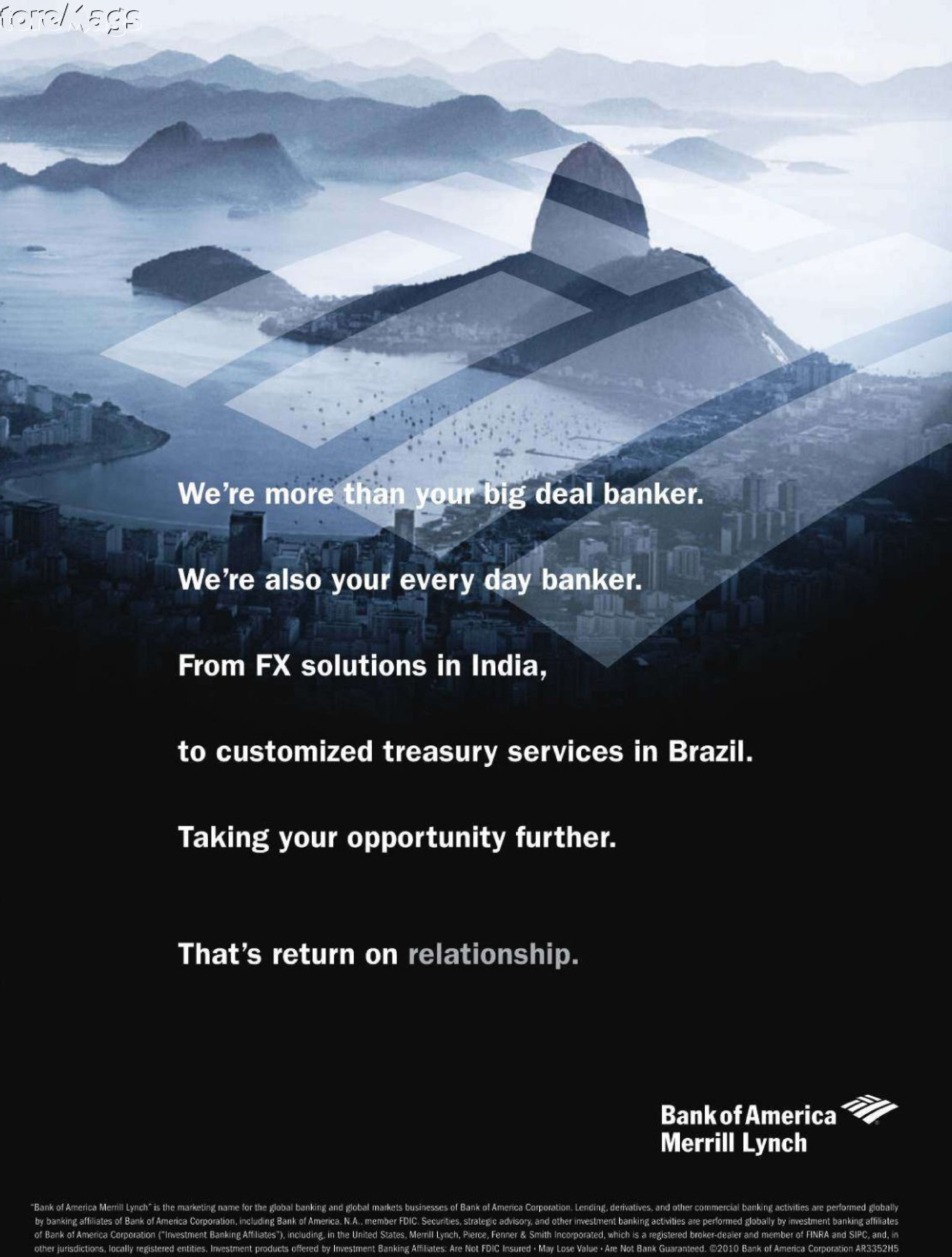
9 Jewels once belonging to the Duchess of Windsor fetched $12.4 million at a **Sotheby's** auction in London.

10 Stanley Ho, billionaire chairman of Macau-based casino operator **SJM Holdings**, won two pieces of rare white truffle weighing 2.87 lb. with a bid of $330,000 at a charity auction.

CLOCKWISE FROM TOP: DENIS DOYLE/BLOOMBERG; ADAM ROUNTREE/BLOOMBERG NEWS; FERDAUS SHAMIM/WIREIMAGE/GETTY IMAGES; APTN/AP; DMITRI KESSEL/TIME LIFE PICTURES/GETTY IMAGES; OPI

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Contents
▶ How FM Global plays with fire to make factories safer 64 ▶ Insurance costs for banks rise as the FDIC prepares a wave of lawsuits 65 ▶ Emerging threats to corporate data 66 ● Edited by David Rocks

Focus On

Risk Management



PHOTO ILLUSTRATION BY LABOUR FOR BLOOMBERG BUSINESSWEEK

The Growing Peril Of a Connected World

▶ Munich Re is trying to find the new dangers lurking in a rapidly globalizing economy

▶ Safety improvements can boost recklessness: "Everyone has their own risk thermostat"

Last Apr. 14, Iceland's Eyjafjallajokull volcano erupted. Five days later, **Nissan Motor** shut down three auto assembly lines in Japan. The factories had run out of tire-pressure sensors when a plane carrying a shipment from a supplier in Ireland was grounded because of volcanic ash. At a **BMW** plant in Spartanburg, S.C., work slowed after transmissions couldn't be delivered from Germany.

What was the probability of that happening? That's the kind of question **Munich Re** must grapple with. Munich Re is the world's biggest reinsurer, one of a handful of industry giants including **Swiss Re** and **Berkshire Hathaway**'s Gen Re that sell policies to insurance companies to cover the risks they absorb from policyholders. That gives the 130-year-old company an unparalleled view of just about everything that could go wrong in the world. And in a global economy, figuring out where and why those things might happen is getting a lot more complicated. "The most significant changes in risk management have taken place in the past 7 to 10 years," says Joachim Oechslin, Munich Re's chief risk officer. "Today it's not only about data gathering"—using geological records, say, to predict the likelihood of a volcanic eruption—"but trying to figure out the relationship of things," such as how an event like the Iceland volcano can ripple through a supply chain. While Munich Re specialists are studying the eruption, they say they still lack the tools to accurately predict the chain of damages unleashed by such a disaster.

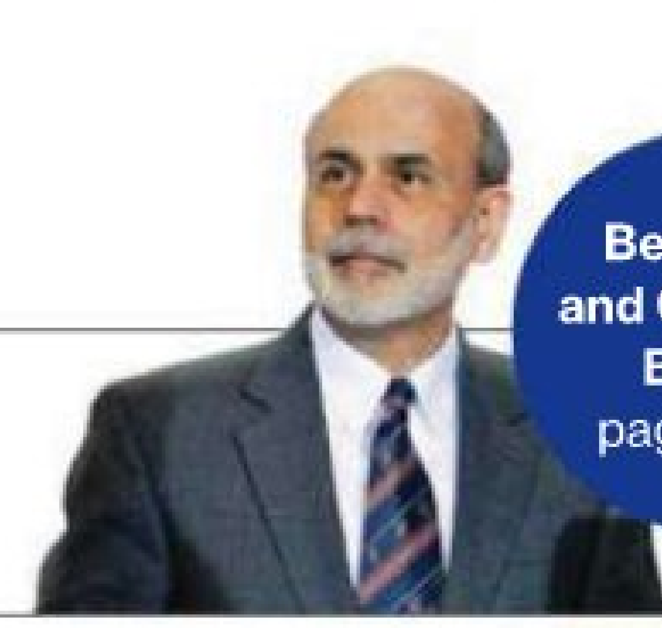
Increasingly, Munich Re is focusing on subtle trends that could carry the seeds of disaster

Inside its neo-Baroque headquarters overlooking the tree-lined walkways of Munich's English Garden, Munich Re specialists pore over data to help them calculate the likelihood of a dizzying array of mishaps. They know the probability that Los Angeles will suffer a major earthquake in the next three decades (it's 97 percent) and the odds that a 60-year-old American man will die from a heart attack by age 70 (3.2 percent if he doesn't smoke, and 8.4 percent if he does). They search for patterns in data from past accidents, learning, for instance, that boats are most likely to spring leaks during the early months of an economic upswing. The reason: During downturns, vessels are often placed in dry-dock, where wood shrinks as its dries,

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Bernanke and Geithner: BFFs? page 68 ▶

leaving gaps where water can enter when the boat returns to service.

Increasingly, Munich Re is focusing on what it calls emerging risks: subtle, often seemingly innocuous trends that could carry the seeds of disaster—everything from rising prices at art auctions (which can increase theft) to the widespread installation of rooftop photovoltaic panels (a fire risk). Who knew that bundled subprime mortgages would lead to a near collapse of the global financial system? Munich Re had a pretty good inkling. In 2007 its analysts concluded that collateralized debt obligations were far riskier than was generally realized. The company wrote new policies for clients in finance, setting tighter limits on its potential exposure to losses from such instruments, and came through the crisis in strong shape. In 2009, its profit rose 53 percent, to $3.5 billion, on revenue from premiums of $55.1 billion.

Munich Re learned the hard way about the need for more sophisticated risk controls. A decade ago, it had invested about 20 percent of its capital in equities. "We had the profile of a hedge fund rather than an insurance company," Oechslin says. After markets worldwide tanked in 2002, the company booked an unprecedented $492 million loss for 2003. Since then, Munich Re has greatly diversified its investments, with less than 3 percent in equities. "They have their house in much better order than they did five or six years ago," says Paul Walther, chief executive officer of Reinsurance Directions, a Florida consulting firm.

One of the new risks Munich Re is tracking is climate change. The company has the world's most comprehensive database on natural disasters, with information going back centuries. It shows that the frequency of serious floods worldwide has more than tripled since 1980, while hurricanes and other severe windstorms have doubled. "Global warming is real, and it affects our business," says Peter Hoppe, who heads the company's climate-change research. Munich Re has become a leading advocate for renewable-energy development, even joining a venture that plans to generate solar power in the Sahara and ship it under the Mediterranean to Europe.

97%

Risk of a major earthquake in Los Angeles by 2040

SOURCE: MUNICH RE

Other Munich Re specialists try to understand human risk-taking behavior. Rainer Sachs, who heads the company's emerging risks research unit, spends his days pondering such head-scratchers as the fact that, while traffic deaths have dropped sharply in recent years, the rate of serious injuries from accidents has not. His conclusion, buttressed by studies of driver behavior in several countries: With airbags and other safety features, drivers take more risks because they believe their cars are safer. "Everyone has his own risk thermostat," he says. "We introduce risk-mitigation devices that are supposed to make life safer—and then we change our behavior to make life more interesting."

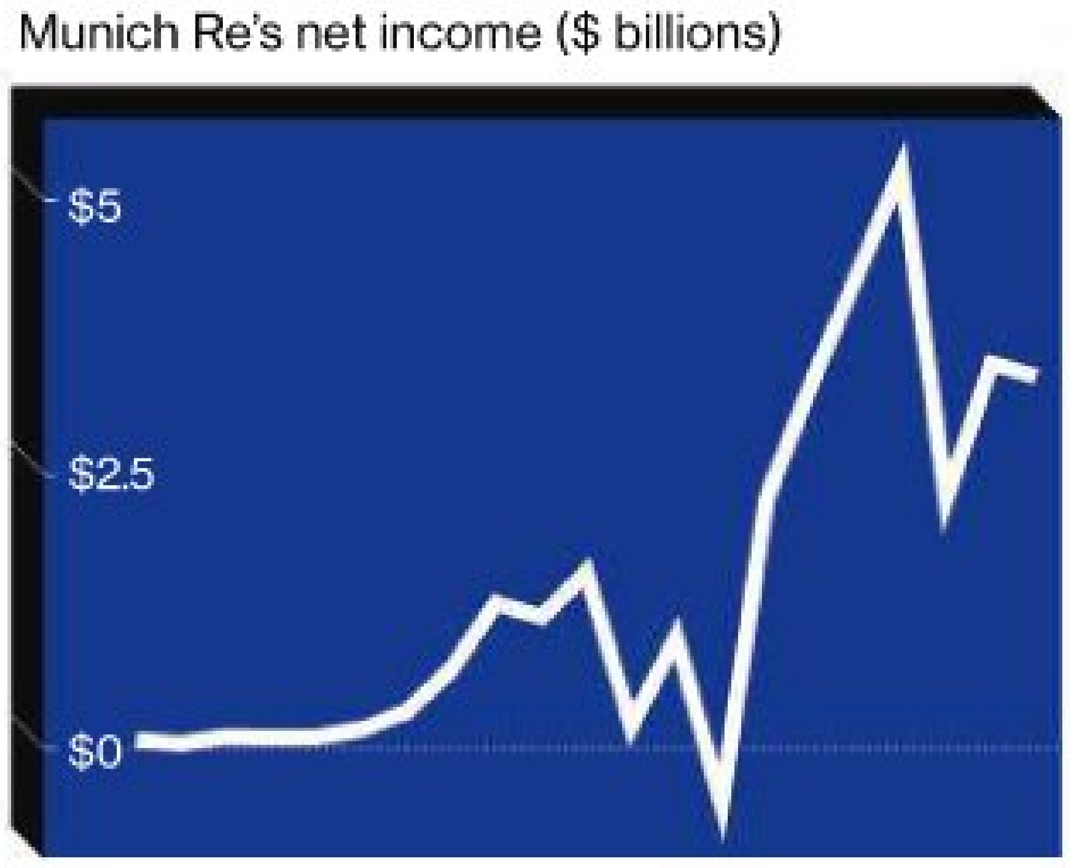
Those insights could help Munich Re develop computer models to predict the likelihood of accidents in a wide range of settings, including financial markets. Sachs contends that a similar thermostat effect figured in the global crisis. "When people invested in subprime products, they bought hedging products, so they felt safe," he says.

Other human behaviors defy prediction. Terrorism, for one. While insurers can draw conclusions by studying the actions of groups of people, "You cannot model the decision-making of small numbers of individuals," says Heike Trilovszky, Munich Re's corporate underwriting chief. "We're convinced that terrorism is not insurable." —*Carol Matlack*

The bottom line *As the global economy gets more connected, it has become harder for insurers like Munich Re to determine risk.*

Profiting from Risk

Munich Re's net income ($ billions)



DATA: BLOOMBERG

Property

Cutting Danger by Playing with Fire

▶ **FM Global shakes, rattles, and burns its way to safer factories**

▶ **"That was the third time I've seen that test, and it still makes me jump"**

The fire begins as a slow burn. Within minutes, fueled by 216 neatly stacked boxes full of plastic cups, 30-foot flames lick the ceiling, and crackling embers soar up from the melting plastic goo. When automatic sprinklers start dousing the fire, the room fills with thick, black smoke. "Can you imagine that smoke in our warehouse?" whispers one observer standing behind reinforced glass.

The blaze was a test of sprinkler configurations by Factory Mutual Global, a 175-year-old insurance company that spends about $40 million annually figuring out how to increase safety and minimize losses at factories, warehouses, baseball stadiums, and other business locations. FM Global runs a sprawling 1,600-acre disaster research facility on a winding road in rural Rhode Island, where researchers wreak as much controlled havoc as possible, sparking explosions, simulating earthquakes and hurricanes, pelting glass with ice balls shot from a hail gun, and more.

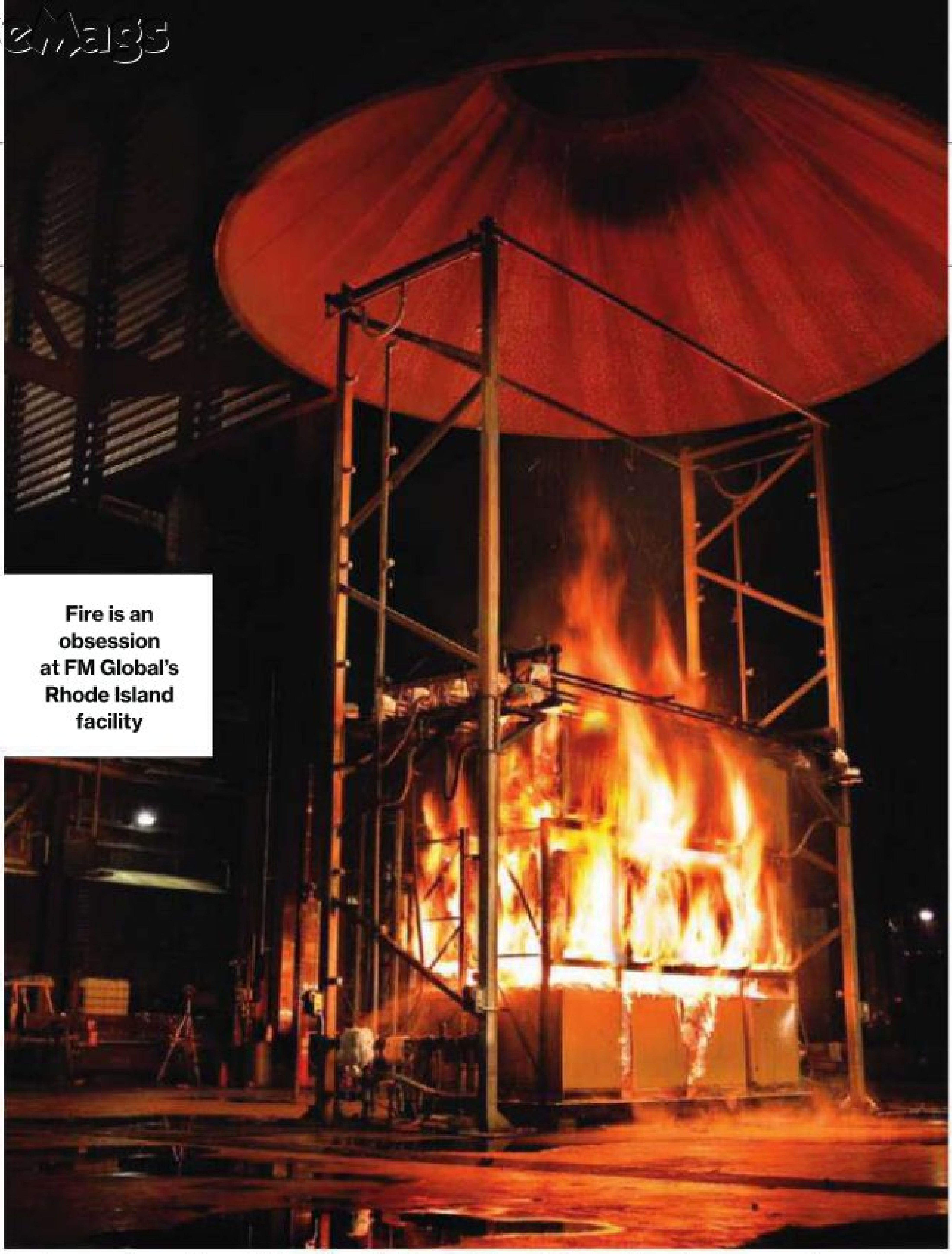
The insurer was founded in 1835 by New England mill owners who pooled their resources to develop safer factories and create a fund to cover each other against losses from fires and other disasters. Today, it's the biggest U.S. insurer of large commercial properties when measured by premiums paid, with 26.8 percent of that market, according to Advisen, an insurance industry analyst group. Last year, FM Global's operating income quadrupled, to $1.2 billion on revenues of $4.6 billion.

FM Global is still owned by its clients, about 2,000 companies such as General Electric, Boeing, and Caterpillar. While its premiums start out higher than many rivals', clients say it's worth paying extra to get access to the company's scientists, who make factory visits and even inspect construction sites before facilities are built to offer advice

ANDREW HARRER/BLOOMBERG

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Fire is an obsession at FM Global's Rhode Island facility

on improving safety. "We value their prevention mindset that gives you engineers who are involved almost from Day One," says Gerald Colonna, Global risk director at AveryDennison, a printer and packaging maker that has been a client since 1965.

FM Global employs 125 scientists at its Rhode Island campus and a smaller facility in Massachusetts. Their work consists of "testing things until they break," says Louis Gritzo, the company's research manager. The lab's earthquake simulator moves in six directions to replicate the motion that would be experienced on different floors of buildings when hit by earthquakes of various magnitudes. The burn lab is twice the size of a football field and can accommodate flames that rise 60 feet in the air. When clients "see those scenarios played out, you can be sure that they'll make safety improvements," Gritzo says. Customers that follow FM Global's advice typically see their premiums drop.

A risk management delegation from McKee Foods, the maker of Little Debbie snack cakes, was impressed by a November demonstration of how explosive dust can be. The FM Global team tossed about a quart of resin dust into a concrete bunker with one wall made of a plastic tarp, then ignited it with a tiny spark. With a bang, a 20-foot burst of flames shot through the tarp. "That was the third time I've seen that test, and it still makes me jump," says Micheline Parkey, a risk manager for McKee.

Fire is FM Global's primary focus, and sprinklers are given star status. The research lab features a display case with 1,000 different sprinkler heads, each framed in its own glass enclosure. Fire is the leading cause of property loss at companies, and FM Global's researchers have touched off more than 30,000 blazes over the years to study how various items–stacked rolls of cigarette paper, boxes containing aerosol, electrical equipment, and thousands of other things–burn and respond to different sprinklers under varying humidity and temperature conditions.

The insurer chooses experiments based on the findings of its 1,800 engineers who inspect roughly 100,000 customer facilities worldwide each year to pinpoint new hazards and advise clients on safety improvements. For their experiments, FM Global engineers and technicians make computer simulations and full-scale models of client facilities. They build and abuse at least one physical structure daily, with each test costing from $10,000 to more than $100,000.

When Hurricane Katrina struck, FM Global had insured 400 properties along the Gulf Coast near New Orleans. About half of them had successfully implemented the insurer's safety recommendations, and those facilities suffered 80 percent less damage than the sites that hadn't, FM Global says. At an Ocean Spray grapefruit processing plant in Florida, the insurer's inspectors suggested reinforcing the roof and installing an auxiliary power generator. When the site was hit by two hurricanes that devastated the Florida coastline in 2004, Ocean Spray suffered negligible damage while a nearby competitor's facility had to be shut down. That year, Ocean Spray's sales soared due to reduced competition. "Much of the grapefruit crop that year was destroyed," Rick Lees, Ocean Spray's chief financial officer, said in an e-mail. "It would have been very difficult to replace our concentrate if it had been lost."
—*Caroline Winter*

The bottom line *Engineers at insurer FM Global's Rhode Island lab burn and shake all manner of goods to find safer ways to build and operate factories.*

Finance

Lawsuit Fears Push Up Costs for Risky Banks

- The FDIC aims to recover losses from leaders of failed institutions
- "If this goes on for a long time ... there could be further tightening"

On Nov. 1, the Federal Deposit Insurance Corp. sued 11 former officers and board members of Heritage Community Bank, a Glenwood (Ill.) lender closed by state regulators last year. The complaint alleges that the bank's leaders ignored losses on risky commercial

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Risk Management

real estate loans while paying out millions of dollars in dividends and bonuses. The lawsuit, seeking at least $20 million, foreshadows a likely wave of litigation against the people who ran the 314 banks that have failed since the start of 2008. The FDIC has authorized lawsuits to recover more than $2 billion from scores of former bank officials.

Whatever the FDIC wins will probably come from directors and officers insurance, which companies buy to cover damages when managers are found liable in lawsuits filed by shareholders or regulators. The FDIC "has a fiduciary duty to collect money," says Jeff Gerrish, a Memphis attorney for community banks who in the early 1980s oversaw the agency's division in charge of suing directors of failed institutions. "It will bring a claim where there's insurance or where the directors have a personal ability to pay."

Although the rates banks must pay for D&O insurance have eased somewhat over the past year after spiking during the financial crisis, they're now rising fast for many community banks at risk of failure. A healthy bank might pay $70,000 annually for $5 million in coverage, while troubled banks pay four or five times that amount, estimates Kevin LaCroix, a partner at broker OakBridge Insurance Services in Beachwood, Ohio. He says one of his clients, a small bank that is operating under a warning from regulators, saw its D&O premiums more than quadruple this year. Lawsuits from the FDIC could affect premiums even for healthy banks if insurers haven't set aside enough money to cover claims. "If the number of failed institutions continues to swell, there could be further tightening," LaCroix says.

After the savings and loan crisis in the 1980s, the FDIC sued officials from about one quarter of the failed institutions. This time around, the agency has so far settled just one case, with a bank it declines to name, for $897,000—the entire value of a $1 million D&O policy after defense costs were deducted. The agency has launched two lawsuits: against managers from Heritage and failed California lender IndyMac Bank. (Former executives at both banks have denied any wrongdoing.) And it has notified officials from 164 failed banks that it may pursue claims, FDIC spokesman Andrew Gray says. After a bank goes belly-up, the agency has three years to sue. That means executives at most banks that closed during the recent financial crisis could face lawsuits through the end of 2011.

D&O premiums for financial institutions declined almost 10 percent last year, to an average of $133,000 for $5 million in coverage, according to a report by insurance brokerage Aon. Still, the report notes that "financial institutions, and particularly community banks, continue to face a difficult D&O market." That will only get tougher as the FDIC begins to take more former bank officials to court to recover some of the billions the crisis has cost the agency, says David Payne of Aon's Risk Solutions group. "We are early in the litigation process," he says. "The FDIC is very busy with just managing the process of failed banks."

—*John Tozzi and Suzanne Woolley*

The bottom line *Rates for directors and officers insurance for community banks have risen sharply as the FDIC prepares a wave of lawsuits.*

23

PERCENT

Midsize companies ($1 billion-$5 billion in sales) that say they have a chief risk officer, up from 9 percent in 2004

DATA: AON

Speed Dial Brian Cummings

The head of Tata Consulting's North American information risk practice on emerging threats to our data—and how to fight back

What's putting our data at risk now?
We're seeing a new weakness unfold with cloud computing. The misconception is that if I transfer to a cloud service, they become responsible for my security. The burden is on the customer to make sure the cloud service meets their requirements.

Many companies are getting more aggressive on data security. Is it paying off?
There's a recent report from Deloitte that shows the number of intrusion attempts is on the rise, but successful intrusions have gone down. That speaks well to the controls organizations are putting in place. The attacks are not only increasing, but they're increasing in sophistication.

Where are companies falling short?
The trick now is to turn that greater effort inward and take control of the insider threat. Insiders have greater knowledge, they have access. The trend over the last year is to focus on behavior analytics or insider surveillance, or whatever you want to call it. A credit-card company was recently having trouble with celebrity account data. Their employees were selling it to paparazzi, but their system couldn't pinpoint who was doing what.

What's the scariest digital aspect of your own life?
Mobile transactions. I only leave my credit-card information on what I think are the best-protected sites. And when I do, I use one with a very low credit limit—say, $1,000—to protect myself and my bank. Ⓑ —*Barry Maggs*

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Tim Geithner and Ben Bernanke kept the U.S. out of a depression. But the Fed's latest moves have triggered fierce attacks that have forced them to fight back together


The Partnership

By Rich Miller

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On the morning of Nov. 4, two days after the midterm elections, Timothy Geithner was scheduled to fly to Kyoto for a dinner with Asian-Pacific finance ministers. At the last minute, Geithner postponed his trip; there was just too much going on in Washington. The dimensions of the electoral drubbing that President Barack Obama had taken were still sinking in when the Treasury Secretary arrived at the White House to plot strategy at the President's cabinet meeting.

After the occasion, Obama extended an olive branch to newly empowered Republican leaders, inviting them to meet later in the month. Geithner, though, had no illusion that peace was breaking out. In fact, as he returned to the Treasury Dept. for a private lunch with Federal Reserve Chairman Ben Bernanke, the next political battle was already taking shape. Bernanke would be the new target.

Bernanke and Geithner, who sat for separate interviews for this story, won't say what they discussed at their Nov. 4 lunch; an official describes the meeting as routine. As the Administration's point man in its dealings with the Fed, Geithner lunches with Bernanke almost every week. The Treasury Secretary says there's one topic that's off-limits: "I don't give him advice on monetary policy for two reasons. One is out of respect for the basic independence of the Fed. The other is because I'm not living and breathing monetary policy every day."

The two had been scheduled to get together earlier that week but waited until immediately after a two-day Fed meeting that began on Election Day—the same session, as it turned out, that put Bernanke in play politically. At the meeting, Bernanke faced down opposition from Kansas City Fed President Thomas M. Hoenig and pushed through his plan for a second round of "quantitative easing"—pumping $600 billion into the economy over the next eight months by buying long-term Treasury debt. The strategy was designed to boost the flagging U.S. economy, bring the unemployment rate down from its painful 9.6 percent level, and prevent a Lost Decade of low growth and deflation similar to the one Japan suffered after its real estate bubble burst in 1990.

With the impact of Obama's $814 billion stimulus program fading and Republicans unwilling to spend more, the President was depending on the Fed to prod the recovery. And Fed officials say they felt obliged to act—to try to reduce unemployment they think is dangerously high and increase inflation they fear is dangerously low. With short-term interest rates already near zero, they sought to bring down long-term rates by taking the unorthodox approach of buying Treasury bonds. The move had already elicited protests from German and Brazilian officials, who worried it would drive down the value of the dollar, making their exports costlier in the U.S. Bernanke and Geithner expected more complaints at the Group of 20 summit in South Korea the following week. They didn't anticipate the size of the battle that erupted at home.

The political attacks on the Fed—once the most sacrosanct of government institutions—started slowly, with Tea Party-backed candidates such as Rand Paul, running for the U.S. Senate in Kentucky, campaigning against the central bank. When Bernanke announced round two of quantitative easing (or QE2, as it became known) on the day after the election, the response was swift. Indiana Representative Mike Pence, a conservative bellwether and possible 2012 Presidential candidate, released a statement accusing the Fed of "masking our fundamental problems by artificially creating inflation." A few days later, former Alaska Governor Sarah Palin, the unofficial leader of the Tea Party wing of the GOP, posted on her Twitter account that the Fed was planning to "print $ out of thin air."

On Nov. 8, Palin dragged Bernanke more directly into the fray. In a speech in Phoenix, she demanded that he "cease and desist" before his "pump-priming addiction" brought "permanently higher inflation." On Nov. 15 a group of 23 mostly Republican economists, money managers, and former government officials sent an open letter to Bernanke arguing that the central bank's bond purchases "risk currency debasement." Two days after that the four Republican leaders in the House and Senate—John Boehner of Ohio, Eric Cantor of Virginia, Mitch McConnell of Kentucky, and Jon Kyl of Arizona—wrote to Bernanke to express their "deep concerns" over bond purchases that could lead to "hard-to-control, long-term inflation and potentially generate artificial asset bubbles."

Ever since, Bernanke and Geithner have found themselves pitted against the Republicans and the Tea Party in a battle that could help determine the fate of the economy, Obama's Presidency, and the Federal Reserve itself. Some of their opponents, such as Pence and Tennessee Senator Bob Corker, want to strip the Fed of its mandate to pursue full employment and focus on price stability alone, which would make it harder to justify future rounds of quantitative easing. The most radical antagonists want to go further. Senator Rand Paul and his father, Representative Ron Paul of Texas, argue for doing away with the central bank altogether. Forty-one percent of

"The Fed faces its biggest political risk since Paul Volcker was chairman," says Lyle Gramley, who was on the central bank's board in the 1980s

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With Obama last June: For the President's opponents, Bernanke is a proxy target

Republicans and 55 percent of Tea Party supporters believe the Fed should be abolished or radically overhauled, according to a Bloomberg National Poll conducted Oct. 7-10.

For Bernanke, who craves the freedom and flexibility of his predecessors to do what he thinks is right for the economy, this amounts to a political choke hold. "Republicans are using him as a proxy for Obama and are determined to make life miserable for both the Fed and its chair," says Arthur Levitt Jr., the former head of the Securities and Exchange Commission who is now a member of the board of Bloomberg, publisher of *Bloomberg Businessweek*, and a policy adviser to Goldman Sachs. "The Republicans know this will embarrass Obama."

On Dec. 1, critics of the Fed got more to chew on when the central bank released details of the recipients of $3.3 trillion in emergency loans, asset purchases, and other Fed programs that helped shore up markets during the worst financial panic since the Great Depression. The documents were made public because of a sunshine provision that Vermont Senator Bernie Sanders added to the Dodd-Frank financial reform bill. "After years of stonewalling by the Fed," Sanders said after the document release, "the American people are finally learning the ... jaw-dropping details of the Fed's multitrillion-dollar bailout."

1.6%

Yield on five-year Treasuries Dec. 1, up from 1.1 percent when QE2 was announced

In truth, the details didn't drop all that many jaws. The world already knew that the Fed functioned during the crisis as a warehouse for bad debt. Perhaps the biggest revelation was that Goldman Sachs, whose president said the firm didn't need government help to survive, borrowed as much as $24 billion from the Fed in the weeks after the 2008 Lehman Brothers bankruptcy. Another surprise: European banks were among the biggest users of Fed programs. Zurich-based UBS sold more commercial paper through a Fed emergency facility than any other bank, and Deutsche Bank led all bond dealers in trading mortgage securities with the Fed. All of which may have been more interesting to financial analysts than to the public—and none of which stopped the critics from hammering away at Bernanke. The Fed, charged Ron Paul, "prevented a bad recession for the people who deserved it, the big money people who made all the billions when they were blowing up the bubble. They prevented a deep, deep recession for the Goldman Sachs of the world."

There are substantive economic arguments to be made against the Fed's new round of quantitative easing. One senior banker, who does not want to be quoted disparaging Fed policy, says he thinks Bernanke misread the psychology of the markets and risks undermining the Fed's inflation-fighting credibility by buying bonds when deficits are so high. Yet some Republicans acknowledge that the latest attacks are about politics as well as policy. "There is a real perception among Republicans that for all intents and purposes Bernanke is a member of the Administration," says Mark A. Calabria, a former aide to Alabama Senator Richard C. Shelby, the ranking Republican on the Senate Banking Committee. It doesn't seem to matter that Bernanke, a registered Republican, was nominated in 2005 by President George W. Bush, or that politics used to stop at the Fed's front door. "The Fed needs freedom to act and act quickly," says Martin Neil Baily, who served as chairman of the Council of Economic Advisers in the Clinton Administration and is now at the Brookings Institution in Washington. "Those are decisions that need to be made outside politics."

The central bank has come under political attack before, notably in the Reagan years. "The Fed faces its biggest political risk since Paul Volcker was chairman," says Lyle Gramley, who was on the central bank's board at the time. During Volcker's tenure, 1979-87, the attacks on the Fed came from the left and right as the chairman pushed interest rates as high as 20 percent in 1981, crushing the economy in the process.

Bernanke and Geithner forged a relationship during the peak of the financial crisis of 2008-09, when Geithner was president of the New York Fed and then, from January 2009, Treasury Secretary. Together with former Treasury Secretary Henry Paulson, they used the Fed's balance sheet and taxpayer money to prop up the financial system and save the U.S. from another Depression. "The main thing we share," says Geithner, "is that we went through the searing experience of the panic together, trying to design a strategy to contain it and clean up the mess afterward. We have the bond you get from that kind of combat."

"He's taken a lot of heat," Bernanke says of Geithner. "He did things I firmly believe needed to be done. We have a lot of mutual trust."

The two men took different paths to their foxhole. Bernanke spent 17 years teaching and writing about the Great Depression at Princeton University before becoming a Fed

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governor in 2002. Geithner spent most of his career as a government official and policymaker, honing his crisis-management skills in the 1990s as an aide to Treasury Secretary Robert Rubin during the fiscal meltdowns in Mexico, Asia, Russia, and Brazil. In those years, Geithner also helped author a hands-off policy toward the Fed, in which the Clinton Administration refrained from commenting on central bank moves. "If there's a big fight between the government and the central bank, then you have a problem," says Edwin Truman, who has served at both the Fed and the Treasury and is now a senior fellow at the Peterson Institute for International Economics in Washington. "It creates all sorts of uncertainty and financial market volatility about who's on top and who's on the bottom."

The two share a temperament: Each is more pragmatic than political, and neither seems to relish the public aspects of his role. Geithner, says Obama strategist David Axelrod, "is kind of a unique character in this venue, in that he's just here to do a job. He's not looking for headlines or notoriety." The same could be said of Bernanke. Both have at times appeared uncomfortable when presenting or defending their policies. (Geithner's plan to repair the financial system in February 2009 was greeted with a 4.9 percent drop in the S&P 500 Index. Bernanke admitted in September that he should have been more straightforward in explaining why the Fed was unable to avert the bankruptcy of Lehman Brothers.) Colleagues describe them as nonideological, which is not always an asset in Washington. Geithner switched his political affiliation from Republican to Independent as he moved up the ladder at Treasury. Alan Blinder, a former Fed vice-chairman who is now a Princeton professor, says he doesn't understand how Bernanke is a Republican, given his lack of political orthodoxy.

Because of their personal bond and common interest in protecting their economic prescriptions from political interference, Bernanke and Geithner tend to look out for each other. "They've wisely not allowed themselves to become Siamese twins," says Senator Christopher Dodd, outgoing chairman of the Senate Banking Committee. "They're complementing each other and utilizing the tools of their offices to enhance common goals—without appearing to be sitting in the same boat, but rather rowing two boats in the same direction."

In February 2009, Bernanke took Geithner's side when the Treasury Secretary was fighting calls for the government to take over large, ailing banks—a step that Bernanke's predecessor, Alan Greenspan, suggested might be necessary. Geithner's alternative, dreamed up on a beach in Mexico while he was between his New York Fed and Treasury jobs, was to put the biggest banks through Fed stress tests before forcing them to take on more capital. He ultimately prevailed, but only after a nine-hour White House meeting on Mar. 15 during which Geithner and his consigliere Lee Sachs faced down skepticism from the rest of Obama's brain trust, including White House National Economic Council director Lawrence H. Summers.

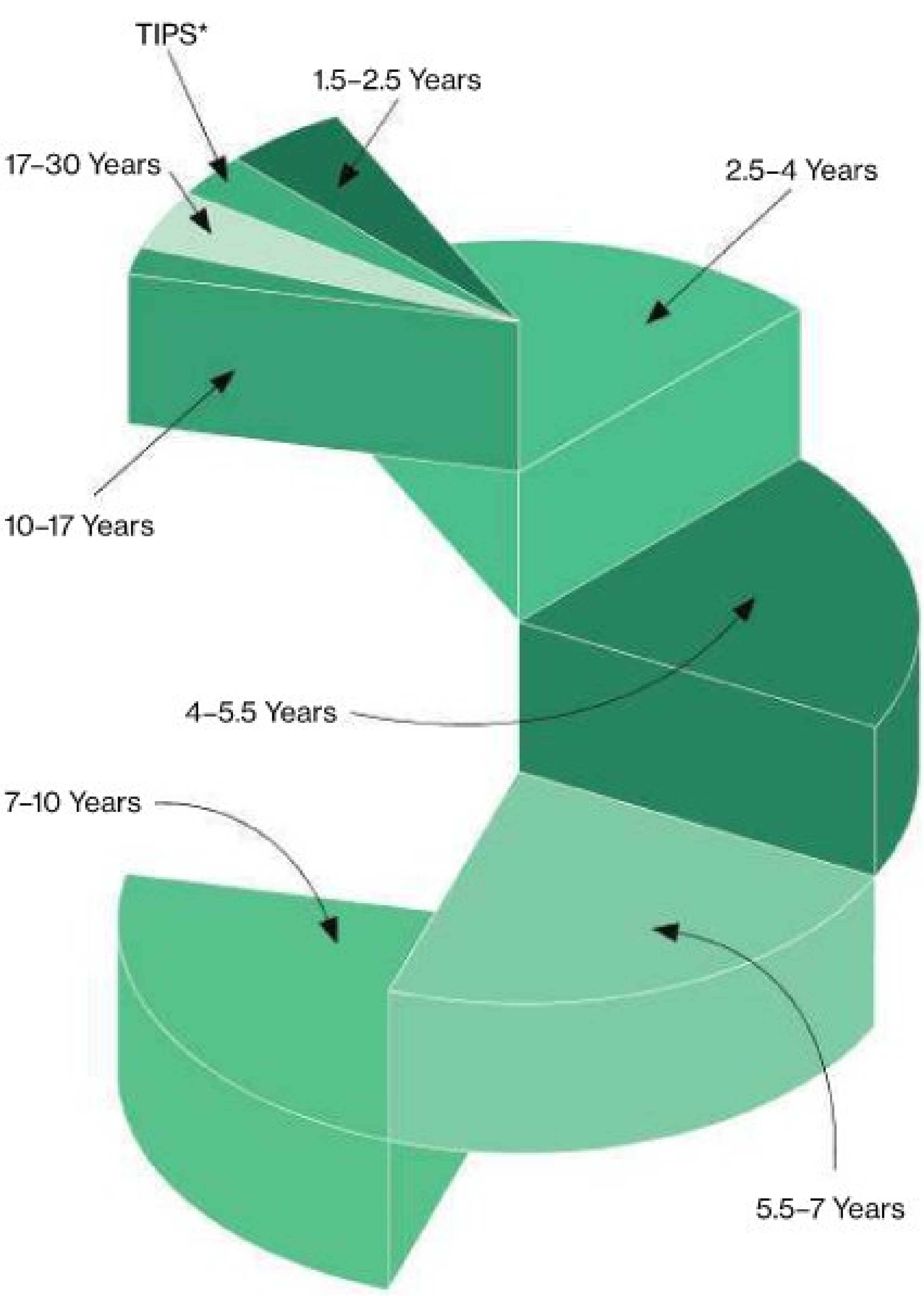
The favor was returned later that year when Obama, advised by Geithner, nominated Bernanke to another four-year term as Fed chairman, choosing him over Summers. In backing Bernanke, Geithner was favoring a new ally over the man most responsible for his own rise through the ranks at Treasury. With the economy still fragile and Bernanke's credibility with investors high, Geithner felt it wasn't the right time to make a change, officials say. Geithner took to the phones when Bernanke's renomination looked in jeopardy in the Senate last January. "Tim played an important role in persuading some reluctant senators to support Bernanke's confirmation," says Alan Krueger, a former Treasury chief economist under Geithner who returned to Princeton last month. The Geithner-Bernanke alliance was further cemented during the year-long debate over financial reforms, which Obama signed into law last July. Led by Geithner, the Administration fought off congressional efforts to rein in the Fed's independence. Bernanke emerged stronger than ever.

Bernanke and Geithner aren't fixtures on the Washington social scene, but they do see each other when there's time. Bernanke routinely invites Geithner to baseball games at the Washington Nationals' ballpark south of Capitol Hill; Geithner has only been able to attend once, arriving in the third inning and leaving in the seventh. Occasionally one of them will have dinner at the other's house with their wives. A guest at one such gathering at the Geithner household: Liaquat Ahamed, author of *Lords of Finance: The Bankers Who Broke the World,* which details the mistakes that led to the Great Depression. Both men read the book, though Geithner found it so unsettling he sent Ahamed a note saying he could not finish it until the worst of the current crisis was over.

As their relationship deepened, Geithner and Bernanke learned to understand each other through gestures. A knowing chuckle by Geithner suggests skepticism. The

The Fed's $600 Billion Spending Spree


The "quantitative easing" that has brought such ferocious attacks on Bernanke is a program to buy Treasuries in hopes of reducing long-term interest rates. Here's what Ben will be buying through June 2011.



*TREASURY INFLATION-PROTECTED SECURITIES MATURING IN 1.5 TO 30 YEARS   DATA: FEDERAL RESERVE BANK OF NEW YORK

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"They've wisely not allowed themselves to become Siamese twins," says Senator Chris Dodd

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financial crisis generated a number of Geithnerisms, such as "spray foam on the runway," meaning taking steps to limit the fallout when a financial firm crashes. "Two of Tim's favorite aphorisms bear repeating," says Bernanke. " 'Life's about alternatives' and 'A plan beats no plan.' To me, these two aphorisms pretty well sum up what we know about, respectively, economics and political science." There may be new adages to come. Bernanke and Geithner "were very successful in avoiding a depression," says Mohamed A. El-Erian, chief executive officer of Pimco in Newport Beach. Calif. "Now they have to be equally successful in avoiding a lost decade."

The risk is that the attacks could undermine the policy before it's had a chance to accomplish anything. After falling in anticipation of the Fed's move, long-term interest rates rose as criticism mounted. Partly driving the trend: investor fears that Bernanke's Fed colleagues may rally against him, suspending bond buys or at least not extending them when they expire in the middle of next year. "This is going to strengthen his internal opposition," says Vincent R. Reinhart, who directed the Fed's Monetary Affairs Div. from 2001 to 2007. "He's going to have a harder time."

There are limits to what Bernanke and Geithner can do in response to the attacks. As an advocate of Fed independence, Bernanke doesn't want to be seen as doing Obama's bidding. Obama advisers say the White House isn't going to speak out now for the same reason–the threat isn't grave enough, they argue, and to draw the President into the fray would only heighten the danger. Bernanke, for his part, must be careful about speaking out against Republican arguments for immediate budget austerity, even though he believes such a strategy could hurt the recovery. If he answers their attacks, he risks looking like another Obama partisan.

As a former central banker, Geithner is sympathetic to Bernanke's concerns and loath to comment publicly on the Fed's monetary policy actions. Geithner bent that rule after Greenspan suggested the Fed was pursuing a policy of "currency weakening." While professing "enormous respect" for Greenspan, Geithner said the former Fed chairman's comment was "not an accurate description of either the Fed's policies or our policies." In a Nov. 19 interview on Bloomberg Television's *Political Capital with Al Hunt*, Geithner warned Republicans against politicizing the Federal Reserve and said the Obama Administration would oppose any effort to strip the Fed of its mandate to pursue full employment. "It is very important to keep politics out of monetary policy," Geithner said. "You want to be very careful not to take steps that hurt our credibility."

10–1

Votes cast for and against QE2 at the Fed Open Market Committee

Obama is in an especially tricky spot. He too wants to protect the independence of the central bank and avoid playing into arguments that Bernanke is an extension of Obama's economic agenda. As a result, the President was hamstrung in responding to attacks on the Fed's policies from G-20 officials in the run-up to the South Korea summit. Obama's defense was not as robust as some, including Levitt, thought it should be. "The Federal Reserve is an independent body," Obama said at a Nov. 8 press conference in India on his way to the summit. "It doesn't take orders from the White House, and it's important as a policy matter, as an institutional matter, that we don't comment

The Fed in the Crosshairs

"Today, the Federal Reserve has entered uncharted territory. Diluting the value of the dollar by continually increasing the supply of money poses an incalculable risk."
Rep. Mike Pence, Nov. 3

"I think the Fed is injecting high-grade monetary heroin into the financial system of the world, and one of these days it is going to kill the patient."
David Stockman, former director, White House Office of Management and Budget, Nov. 4

"Fed's quantitative easing plan (print $ out of thin air)"
Sarah Palin on Twitter, Nov. 7

"The planned asset purchases risk currency debasement and inflation ..."
Open letter from 23 mostly Republican economists and strategists, Nov. 15

"I'm not saying we're in an undead homicidal zombie market, though we may be."
"Baruch," anonymous financial blogger, Nov. 16

"Such a measure introduces significant uncertainty regarding the future strength of the dollar and could result both in hard-to-control, long-term inflation and potentially generate artificial asset bubbles that could cause further economic disruptions."
Representatives John Boehner of Ohio and Eric Cantor of Virginia and Senators Mitch McConnell of Kentucky and Jon Kyl of Arizona, Nov. 17

"It's time for us to 'refudiate' the notion that this dangerous experiment in printing $600 billion out of thin air, with nothing to back it up, will magically fix economic problems."
Sarah Palin, Nov. 18

"There is nothing more insidious that a government can do to its people than to debase its currency. ... Inflation is a killer of wealth. It wipes out the middle class. It eviscerates the standard of living ..."
Representative Paul Ryan, Nov. 21

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on particular Fed actions." He added, "I will say that the Fed's mandate, my mandate, is to grow our economy."

Having spent months laying the groundwork for QE2— starting with a Bernanke speech on Aug. 27 in Jackson Hole, Wyo.—Fed officials say they were surprised by the fierce criticism that greeted the move. In the scramble to respond, central bank officials urged sympathetic economists to write newspaper pieces, and laid out their arguments in print interviews and TV appearances. Bernanke went to Capitol Hill to brief members of the Senate Banking Committee. He has defended the bond purchases as a natural extension of monetary policy—a way to bring down long-term interest rates, boost growth, and fend off deflation. In an opinion piece in *The Wall Street Journal*, Blinder, the former Fed vice-chair, supported his old friend's view, calling the bond purchases "garden-variety monetary policy" and labeling the Fed's critics "the economic equivalent of the Flat Earth Society."

The counterattack had little effect. Palin fired back with a letter to the *Journal* warning of the "clear and present danger" of the Fed "working its printing presses overtime" as the U.S. sinks "even deeper into debt." Some Democratic strategists suggest the Administration should not allow itself to be sucked into this fight. "They shouldn't respond to her," says pollster John Anzalone, who worked for Obama's 2008 campaign. "Few people have credibility on an issue this weighty, and she isn't one of them." Palin didn't respond to requests for comment.

Bernanke is not backing down from his decision. While the economy has shown some signs of picking up, it has yet to achieve escape velocity. Growth is likely to average 2 percent over the last three quarters of 2010, too slow to make a dent in the unemployment rate. And if joblessness climbs back to 10 percent, that could sap what little confidence consumers and companies have, sending the economy back down. It's that dangerous cycle Bernanke is seeking to break. That's why the Fed opted to act despite the criticism.

In the back of Bernanke's mind is Japan. Both he and Geithner share an interest in that country's travails—and a desire to avoid seeing them visit the U.S. "The big risk on the table is a lost decade like Japan," says Mark Gertler, a friend of Bernanke's and professor of economics at New York University. "Both Geithner and Ben are acutely aware of that." Geithner, who speaks Japanese, worked as a Treasury rep in the U.S. embassy in Tokyo in 1990-91. Bernanke wrote a scathing paper about Japan's policies while at Princeton in 1999, then followed up with critical speeches after he became Fed governor in 2002. He focused his criticism on Japan's monetary policy, accusing its central bankers of being too timid in tackling deflation. He suggested they finance a tax cut by buying government bonds. Bank of Japan officials chose not to take his advice, partly out of fear such a move would undermine the central bank's independence.

Geithner insists the U.S. won't go the way of Japan. "We were much more aggressive at an earlier stage in the crisis than has been true for any major country, including Japan," he says. The biggest U.S. banks have been recapitalized. Companies have moved rapidly to lay off workers and shut down excess capacity. And policymakers have been quicker on the draw, with the Fed cutting short-term rates to zero in December 2008 and Obama pushing through a stimulus program just after taking office. "If you look forward from now," Geithner adds, "we have a much healthier balance sheet in the nonfinancial corporate sector than Japan had and a much healthier balance sheet in the financial sector."

Geithner is set to oppose Republicans if they immediately insist on big budget cuts. "We can muster a policy consensus to avoid a large, premature contraction" of fiscal policy, he says



Bernanke in front of the Senate Banking Committee

Yet with all of that, the U.S. economy has not achieved a self-sustaining recovery. Growth downshifted in the second and third quarters, to the surprise of both Bernanke and Geithner. Just as in Japan, borrowers in the U.S. remain saddled with too much debt, while banks remain cautious about lending. Geithner has warned repeatedly that one lesson of Japan's Lost Decade is that policymakers must not prematurely withdraw stimulus. That's what Japan did in 1998, increasing value-added taxes in an effort to tackle its ballooning deficit. The move pushed the economy back into recession. Geithner is determined to avoid the same thing in the U.S. and is ready to oppose victorious Republicans if they insist on big, immediate budget cuts. "We're fighting against that," he says, adding, "I think we can muster a policy consensus to avoid a large, premature contraction" of fiscal policy.

Now it's the Fed's independence—and its willingness to do whatever it takes—that's being tested. "I don't think the Fed wants to get into a major confrontation with one of the two parties in Congress," says Vin Weber, managing partner of the lobbying firm Clark & Weinstock and a former Republican congressman from Minnesota. The outcry, he says, "is not going to kill Quantitative Easing 2, but it will curtail further easing."

Don't be so sure. Former Fed Governor Laurence Meyer predicts the central bank will end up buying $1 trillion worth of Treasury securities—$400 billion more than planned. And if things get worse and the economy flirts with deflation, expect Bernanke to be even more creative. Fed officials have already talked about the possibility of setting a specific, low target for long-term interest rates, although for now they've decided not to do that because it might entail buying bucketloads of Treasury bonds. That calculus might change if the economy were to relapse. Then Bernanke would be unwilling to let political pressures curtail his monetary moves. That would put the Fed's independence to its biggest test yet. If it happens, Bernanke will once again count on Geithner for crucial support. That's what foxhole friends are for. B

—With Mike Dorning

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One of the most popular tourist attractions in the world has two sides. Canada's has luxury hotels and theme restaurants. America's has corruption and blight. A tale of urban renewal gone horribly awry.

By Andrew Rice
Photographs by Greg Miller

Niagara's Fall

On a misty night in late October, a stringy-haired newspaperman bellied up to the bar at Frankie G's, a musty dive in Niagara Falls, the decrepit city in western New York State that sits atop one of the natural wonders of the world. The editor, Mike Hudson, slapped down some cash and ordered a round of Labatt's for the house, which consisted of five people, including the proprietor. Hudson, the founder of the weekly tabloid *Niagara Falls Reporter,* freely refers to his town as "a godforsaken place," and it was hard to argue with the assessment in the neighborhood surrounding the bar. The area is the worst the city has to offer, a place of drugs and crime and boarded-up brick houses.

A glimpse of the future? Viewing Niagara Falls, Ont., from the New York side

Hudson knocked back a shot of Sambuca and rummaged around for his cigarettes, shouting epithets and contributing jokes to a running discussion on local politics. "It's been all downhill in this town since 1969," said one of the other patrons, a ruddy-faced man who had his first name, Fred, sewn onto his windbreaker. "Ever since they knocked down the whole goddam downtown," muttered the bartender, Frankie G. (short for Giaquinto).

"That's what everyone will tell you about the place," Hudson said later

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that night, over plates of spaghetti at a local Italian joint, which was bedecked with photos of hometown mobsters and dead celebrities.

Niagara Falls' descent into blight—in spite of its proximity to an attraction that draws at least 8 million tourists each year—is a tale that Hudson's little newspaper has been telling for years. It encompasses just about every mistake a city could make, including the one Frankie G. cited: a 1960s mayor's decision to bulldoze his quaint downtown and replace it with a bunch of modernist follies. There was a massive hangar-like convention center designed by Philip Johnson; Cesar Pelli's glassy indoor arboretum, the Wintergarden, which was finally torn down because it cost a fortune to heat through the Lake Erie winter; a shiny office building known locally as the "Flashcube," formerly the headquarters of a chemical company and now home to a trinket market. Once a hydropowered center of industry, Niagara Falls is now one of America's most infamous victims of urban decay, hollowed out by four decades of job loss, mafia infiltration, political corruption, and failed get-fixed-quick schemes. Ginger Strand, author of *Inventing Niagara: Beauty, Power, and Lies,* called the place "a history in miniature of wrongheaded ideas about urban renewal."

Niagara Falls has something that sets it apart from other terminally depressed Rust Belt towns, something that makes its economic failure all the more remarkable: those falls, the 176-foot-tall cascade of thunder that is no less breathtaking for being your grandparents' honeymoon destination. For many years the city's route to a better future seemed straightforward, and it led to the water's edge, where you could look across the border to Canada and see a brightly lit skyline of new high-rise hotels. "It's a booming tourist mecca over there," Hudson said. "Over here, it's a slum."

While the Canadians were building theme restaurants and luxury suites, the American side spiraled downward. Niagara's median household income is now just $30,000, 40 percent below the national average, and one-fifth of its 50,000 residents (down from 100,000 in the 1960s) live below the poverty line. As of November, unemployment was 7.5 percent, lower than the national average; so many have been out of work for so long that they no longer register as part of the workforce.

There's a litany of explanations for this, but for the last decade, through a boom and a bust, several mayors, and nonstop recriminations, a single constant has loomed over the city: the Manhattan real estate billionaire Howard Milstein. In the late 1990s, the municipal government designated a private group backed by Milstein as the "master redeveloper" of 140 acres of downtown real estate. Milstein appeared, at first glance, to be just the man to help the city finally capitalize on its natural potential. He had a hotel and other development interests in Times Square—a fabulously successful example of commercial reclamation—and he proposed to revive Niagara Falls along similar lines, as a casino-centered playground. It never happened. Today, Milstein is still sitting on an enormous swath of land, a ghost town of abandoned homes, shuttered storefronts, and vacant lots in the shadow of a closed-down factory where Nabisco used to make Shredded Wheat.



A long shadow: Billionaire real estate developer Howard Milstein

"Precisely because the community was so excited by the promise of an enormous amount of development over a decade ago, I think today many people in our community feel let down by their inability to build something," said the city's mayor, Paul Dyster. Once hailed as a savior, Milstein is now maligned as a slumlord by many in Niagara Falls. "He's a big boa constrictor," said David Crapnell, a Presbyterian minister and community activist, who accuses the developer of "bad faith." To the pastor, the past decade of dithering and decay offers a parable of the risks any city takes when it wraps up its redevelopment hopes with a rich investor.

Milstein declined multiple requests for comment. Anthony Bergamo, a longtime Milstein lieutenant who is the chief executive of the Niagara Falls venture, places the blame on a dysfunctional city government. As the master redeveloper, Bergamo said, Milstein's role is to assemble and market the site to potential investment partners, such as hotel chains. "We have met with over 150 developers," he said, "all of whom declined to do business in Niagara Falls."

In truth, the failure can't be attributed to any single entity. It's the product of a machine that has for decades been running on unfulfilled promises, from the public and private sector alike, just whirring on in an endless cycle of dashed hope and failed deliverance.

Niagara Falls used to inspire people to dream. In the 19th century an investor named William T. Love proposed to

"It's a booming tourist mecca over there," Hudson said, referring to the brightly lit skyline of new high-rise hotels on the Canadian side of the falls. "Over here, it's a slum."



MILSTEIN: ANDREW HARRER/BLOOMBERG

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Activist Roger Spurback surveys condemned buildings; the government is starting to tear down vacant houses

build a utopian metropolis called Model City there, along the banks of the canal he was digging. His city was never built, and Love Canal went on to become a notorious toxic waste site. "Because it was a place that always drew visionaries and big thinkers, it has always showed the way that the nation is going," said Strand. If economic stagnation and distrust of government are the defining features of this American moment, Niagara Falls charted the way to the bottom.

White Elephant

People in Niagara Falls are so angry, they have not reelected a mayor in 20 years. Things are so depressed that one of Niagara Falls' major crime problems is an "epidemic" of pointless arson, the former fire chief told a local newspaper. In late October, fury led many households in this traditionally Democratic town to put up yard signs that read "I'm mad as hell too, Carl," advertising support for New York's Tea Party-backed gubernatorial candidate Carl Paladino. Although Paladino was trounced by Andrew Cuomo on Election Day, he took more than 60 percent of the vote in Niagara County, and the town threw out both of its incumbent Democratic state legislators.

Niagara's original sin, old timers say, was buying into a particular ideal of progress. A couple of generations ago, when the Canadians started building up their tourism sector, the Americans just laughed. They weren't going to work as bellhops, not when there were plenty of safe union jobs at the state's hydroelectric plant or in the heavy industries it powered. Then, after the manufacturers and chemical companies departed, leaving behind husked factories and brownfields, a second and perhaps more corrosive delusion set in—call it the fantasy of the silver bullet.

The city fathers, in their desperation, embraced a succession of capital-intensive cure-alls. In the 1970s they pinned their hopes on the convention center, soon to become a white elephant, while in the 1980s the Ghermezian brothers, who built the Mall of America outside Minneapolis, proposed to erect a massive shopping complex called Fantasyland right in the center of town. That idea collapsed in the face of local opposition. All the while, Niagara Falls kept getting poorer.

In the late 1990s, a high-living Toronto real estate developer named Eddy Cogan came to town, promoting the latest supposed panacea: gambling. Before a packed house at the convention center in January 1998, Cogan unveiled renderings of an ambitious master plan, produced by a renowned architectural firm, the Jerde Partnership, depicting a new Niagara Falls of leafy plazas and scenic canals built around a Las Vegas-style casino. Cogan promised to make the city into "the Venice of America," and he committed to invest $110 million, if only the state legislature would legalize gambling. In return, the city government gave him the rights to redevelop a large portion of the east side of town as well as other concessions.

Today, Milstein is sitting on an enormous swath of land, a ghost town of abandoned homes, shuttered storefronts, and vacant lots.

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Cogan, a brilliant dealmaker, charmed everyone he met, but as it turned out, he had a problem: He was close to broke. His contract with the city named a number of prominent financial backers, such as Lee Iacocca, but they never gave any public indication that they were actually willing to invest in his company, Niagara Falls Redevelopment (NFR). Cogan turned instead to a deep-pocketed acquaintance, Howard Milstein, selling him a 50 percent interest. "Eddy had no money," said NFR's Bergamo. "It's easy to sell the dream when there's no sense of reality based on the financial ability to perform."

At the time he bought in, however, Milstein said he fully shared Cogan's vision. "This will be the largest redevelopment of a city," Milstein told *The Buffalo News* in 1998. "We can apply everything we've learned about urban design and planning." He had the resources to back up his talk: a family fortune that stood at an estimated $6 billion, amassed by his father and uncle through investments in real estate, banking, and other ventures. "We have enough money," he told the *News*, "to do what we need to do."

"We can apply everything we've learned about urban design and planning," Milstein said. "We have enough money to do what we need to do."

Milstein had a reputation for feuding with everyone from the owners of the Washington Redskins (after they rejected his bid to buy the team) to some of his own relatives (who in the early 2000s forced an acrimonious division of the family empire). Before long, Milstein fell out with his partner in Niagara Falls, too. When Cogan ran into worsening financial problems, Milstein took control. At the time of his death in 2003 from a heart attack, Cogan was still trying to wrest the land back, telling *The Buffalo News* that Milstein had run the project "off the rails."

The Senecas turned Philip Johnson's building into a smoke-filled casino hall and built an adjacent hotel

When Milstein took over, in late 2002, the change in style was apparent at once. The billionaire sent Bergamo, a tough-talking Manhattan lawyer, to meet with Richard Reinhard, the chief operating officer of Niagara Falls Redevelopment. As Reinhard recalled the encounter, the two discussed strategy over breakfast at a diner, the kind of place frequented by local power brokers. Bergamo pressed Reinhard to tell him who was sitting at each table. At the end of the meal he picked up the checks for the ones that he sized up as important and left the waitress a huge tip. "Bergamo said, 'Rick, in a town like this, this is how you buy people,'" Reinhard, who departed the company soon afterward, said. "I remember it like it was yesterday—I thought, oh my God."

"I don't think it's a big thing if I buy coffee and eggs for somebody," Bergamo said in response. As he sees it, over the last decade, his job has revolved around wooing a suspicious populace, and there's nothing wrong with a little diplomacy.

"We're the stranger," Bergamo said in an interview at the offices of Niagara Falls Redevelopment. Sitting in a conference room decorated with maps and drawings of unbuilt buildings, he said that his company has been a good corporate citizen, donating money to dozens of local charities and community groups, and complained that it's been treated with little but scorn in return. "What we have here," he said, "is 50 years of competition to grab crumbs."

In 1999 voters elected a new mayor who promised to break Milstein's already controversial hold on the town. Impatient with the legislature, which had yet to act on a new gaming law, city and state authorities repossessed the convention center and gave it to the Seneca Indian tribe, skirting the law but removing the property from the tax rolls. The Senecas turned Philip Johnson's airy building into a darkened, smoke-filled casino hall, and constructed an adjacent hotel, depriving Milstein's project of the lucrative anchor it required.

Among the many proposals for a replacement revenue generator, put forward by various fly-by-night impresarios or NFR itself, are a dinosaur park, a boxing Hall of Fame, a Chinese-themed attraction called Dragon City, and an underground aquarium featuring 5,000 creatures of the deep. "I have a file full of the craziest ideas," Bergamo said, "but no one comes here with any money." He still claims that success is possible. To illustrate his point, he and his right-hand man, Roger Trevino, led the way across the Rainbow Bridge border post to the Canadian side of the falls. There they do have an aquarium—actually, a giant SeaWorld-like amusement park—along with a gleaming new casino connected to a Hilton, manicured parks, a wax museum, and a well-frequented district of strip clubs. You wouldn't call it classy; you wouldn't call it impoverished, either. Summing up the comparison, Bergamo asked: "Why have they done it when we haven't done it? Corruption. Lack of vision."

Back on the New York side of the falls, the tour continued past some of Milstein's properties. There's the hulking Nabisco plant, which NFR has vainly offered up as a potential new convention

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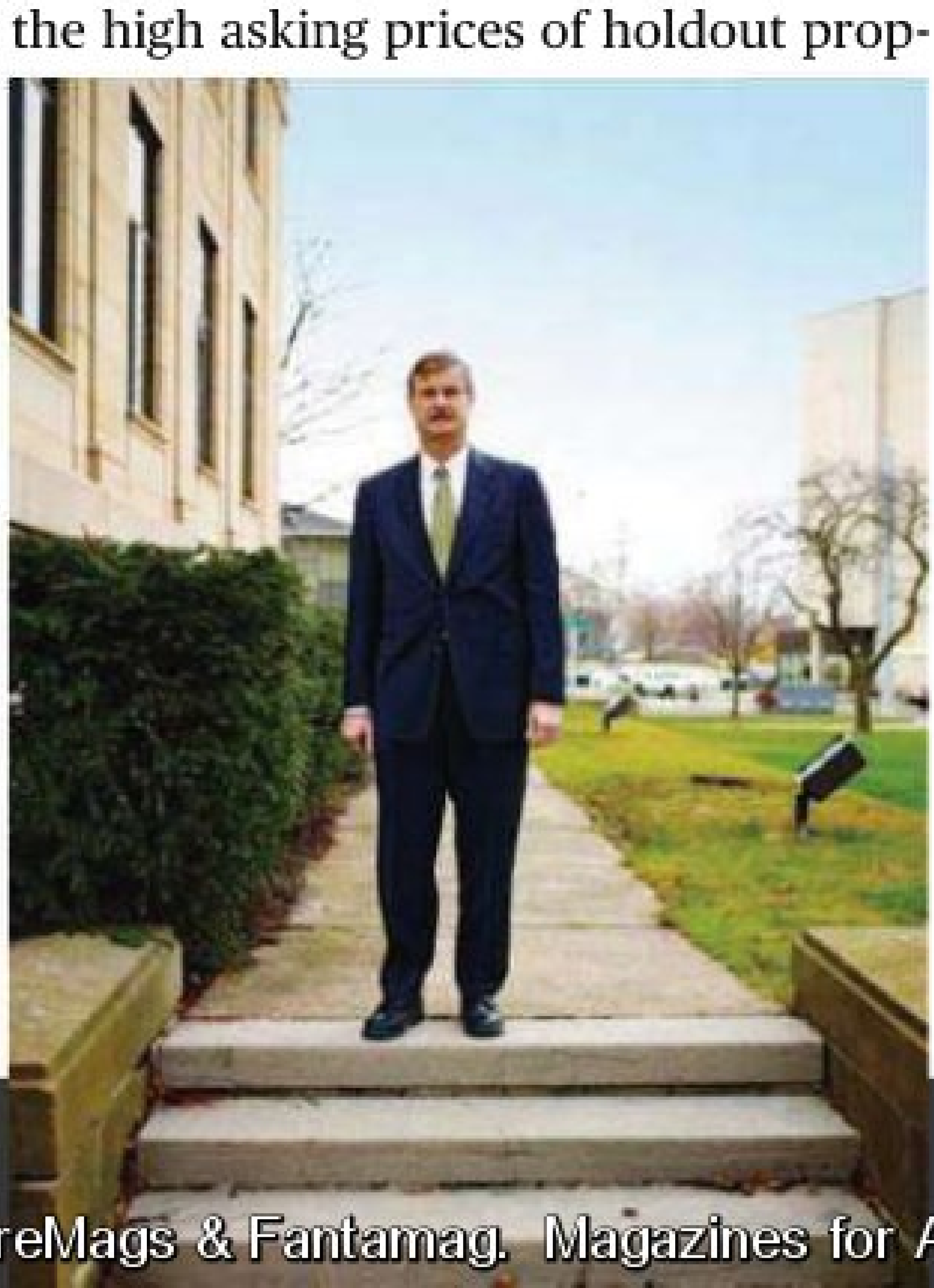
center. There's an odd domed structure known locally as the Turtle, which has sat empty since the long-ago demise of its original occupant, a Native American cultural center. A few years ago, a delegation from Mongolia decided that the building looked like a yurt and wanted to turn it into a museum reflecting their national glory, complete with a 150-foot statue of Genghis Khan that was to be erected in a nearby public park. Municipal officials reacted coolly to the idea of a shrine to the Mongol warlord. "I say history is history," Trevino said. "Why judge?"

Some suspect that such plans are not designed to be taken seriously. Privately, people in the local real estate industry said that Milstein appears to be playing a speculative game, biding his time in the hope that some external force–like massive public investment or legalized gambling–comes to the city's rescue. Bergamo countered that NFR has already invested $55 million to acquire, maintain, and pay taxes on its land. The title "master redeveloper" is not as sweeping as it sounds, Bergamo added: Only a relatively small, city-owned portion of the 140-acre site was deeded over in the original agreement, and much of the area, once a working-class neighborhood, was a checkerboard of lots that had to be purchased from private property holders. In 2008, a highly critical report by the New York State Comptroller's Office examined NFR's contract and the series of renegotiations and missed deadlines that followed it. At one point, the agreement was amended to set a date for Milstein to "commence construction." In response, the company fenced off a public playground within the project's boundaries, poured a concrete foundation, and never built anything further. The comptroller's report faulted the city for failing to adequately enforce its contract. Each side claims betrayal, but neither one seems prepared to go to court over what remains a wasteland, at least for now.

Bergamo said that the company now controls about 85 acres of the total redevelopment zone and has options to purchase a substantial portion of the remainder, but is still dealing with some holdout owners. Some critics argue that it is in the company's interest to keep property values depressed as it tries to buy up the outstanding parcels. "In the process of trying to get rich, he's causing the pain and suffering of other people," Pastor Crapnell said. "He does understand that the more the city dies off, the more he can get those lands for cheap." Milstein's defenders counter that the groups critical of him include some of the holdouts, who are just trying to drive up the price of their land. The company has done itself few public-relations favors, though, through actions like closing the playground and a nearby public recreation center, both moves that sparked community outrage. In 2007 an angry group of protesters gathered to try to break through a locked gate to the gym, and then-Mayor Vincent Anello charged at Trevino. "He said, 'I'm Sicilian–it only takes one bullet, and then I'll spit on your grave,'" said Trevino, who filed a harassment claim with the police. Anello acknowledges that there was a confrontation but denies threatening violence.

Dyster envisions a future built around ecotourism, and hopes to be "a mayor that the people of the city wouldn't be ashamed of"

Relations between Milstein and local officials have been consistently tense, as mayor after mayor has called on NFR to start building or move on. Public officials who are reluctant to be quoted saying anything critical of Milstein complain that his company meddles in local politics and claim that he wields a blunt weapon against opponents: the *Niagara Falls Reporter*. Mike Hudson's muckraking newspaper has been a staunch defender of Milstein and a vicious adversary to his rivals, pushing a bribery investigation of Anello (who later pled guilty to related federal charges), attacking the Seneca tribe and David Cordish, a shopping magnate who owned a derelict mall called Rainbow Centre (he sued for libel), and in one recent issue lambasting the high asking prices of holdout property holders under the front-page headline: "SHAKEDOWN!"



Although Hudson freely admits to being sympathetic to Milstein, whose company is also his paper's biggest advertiser, he denies that he is in anyone's pocket. Niagara Falls, he said, is just not the sort of place where you can avoid taking sides. "Everybody knows everybody," Hudson told me, "and they're either your friend or they're your enemy."

Left Behind

"When does it get to the point where you give up?" asked Roger Spurback.

The community activist was driving his beat-up minivan through the streets of what he calls "one of the neighborhoods left behind." Spurback meant it literally: As the population of Niagara Falls has declined by half, some areas have become almost totally depopulated. Passing entire blocks of vacant houses with sagging roofs and doors sealed off with plywood, the wiry retired autoworker rapidly counted off the ones that were condemned. "One, two, three, four, five. ... " He stopped at 17.

For the past 20 years, Spurback has headed the Niagara Falls Block Club Council, and he is encouraged that at least the government is starting to tear down some abandoned houses in order to manage the city's shrinking footprint. "These are the bad neighborhoods, yes, but we're dealing with them," Spurback said, his tone brightening. He called this "setting the table": demolishing the worst of the past so that a new Niagara Falls can emerge at some unknown point in the future, perhaps with Milstein's cooperation. "It took us 40 years to get here," Spurback said, passing a burned-out nightclub. "It's going to take us 15 to 20 years to get back."

One thing that makes him optimistic, he said, is the leadership of the current reformist mayor, Dyster, who has brought a spirit of competence to City Hall. "This is a city that has much in common with every other Northeastern industrial city, except that it's got Niagara Falls, which means you've got an economic engine to try to create a revival," Dyster said during an interview in his office suite, which was decorated with paintings of the falls and a conspicuous portrait of Franklin Roosevelt. "For that reason it could become a laboratory for change." Politicians have been making similar claims for generations, but Dyster

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is a different breed: a lanky former professor of international relations at Catholic University, he ran for office in 2007 on a platform of clean, efficient governance, and he has since begun to make good.

"One of the things that I said that I would do as mayor would be to try and rebuild the city's image," Dyster said, "and to be a mayor that the people of the city wouldn't be ashamed of." Whereas Niagara Falls was once was a haven for polluters, Dyster envisions a future built around ecotourism. The city's largest allotment of the $787 billion federal stimulus package passed in 2009 is a $16.5 million grant to build a new train station, and progress is finally being made on the old idea of rerouting the Robert Moses Parkway, an underused highway that cuts the downtown off from the riverfront and Frederick Law Olmsted's state park. Dyster has also tried, with some success, to attract companies specializing in alternative energy to a place that was one of the early centers of electrification. In an industrial area on the north side of town, manufacturers such as Globe Specialty Metals and PEMCO are producing high-grade silicon and other materials that go into solar panels and fuel cells.

The new watchword is "incremental." Dyster and other public officials are trying to avoid the magical thinking that led to ideas like bulldozing the central business district or lashing the town's fate to a single developer's whims. "I categorically reject the silver bullet," said Christopher Schoepflin, president of the state-affiliated USA Niagara Development Corp. In an era of tightened budgets, the goal is modest investments in projects that are meant to create a differentiated identity for the New York side of the falls. So instead of Planet Hollywood, the state is preparing to put $4 million toward turning the closed Rainbow Centre mall into a culinary school and restaurant. Grants also subsidized a new wine bar and a concert hall, as well as the conversion of a derelict art deco commercial building into a boutique hotel, offices, and condos.

Among the proposals for the land are a dinosaur park, a boxing Hall of Fame, a Chinese-themed attraction called Dragon City, and an underground aquarium.

Still, it's hard to envision any large-scale revival if Milstein, who controls much of the town's most desirable property, refuses to budge. "I'm not saying that Niagara Falls Redevelopment should give their property away, but they can't sit on it forever," said Robert G. Shibley, founder of the Urban Design Project at the University of Buffalo, which has worked on planning issues with the city. "They've been notoriously difficult to partner with and to move off the dime."

Dyster's relationship with Milstein is chilly, and the *Niagara Falls Reporter* has attacked his administration mercilessly. "I'd almost equate it with Obama," Mike Hudson said. "He's a wonk, for sure, but it hasn't produced any results." Earlier this year, Charles Schumer, New York's senior senator and one of the most powerful Democrats in Congress, waded into the property dispute, moderating a private peacemaking meeting between the mayor and the developer. Dyster told me that when Milstein was asked what would entice him to build something, he replied that it would take a billion dollars of investment to get redevelopment off the ground, and that the government shouldn't look to him for most of that capital.

Bergamo would not comment on what he described as "a private conversation," but said: "Mr. Dyster has his own agenda. ... They are not pro-development people, this present administration. They are green people."

Milstein's critics point to a pattern: The Milstein family is known for buying properties and holding them for years, as in the case of a Times Square parking lot they purchased for $5 million in the early 1980s, clung to through a state effort to condemn and redevelop the area, and only sold in 2006, for the top-of-the-market price of $325 million. Another family-owned property, a giant hole in the ground in Stamford, Conn., has remained untouched since 1984. Many believe that Howard Milstein has adopted a similar strategy in Niagara Falls. While patience could ultimately work to Milstein's benefit, as it did in Times Square, it doesn't promise much in the meantime for the people who actually have to live in Niagara Falls.

"This used to be full of houses," Roger Spurback said, driving into the vast dead zone under Milstein's control. A few red brick ruins dotted the eerily open landscape of grassy lots, which run right up to the parking lot of the neon-lit Indian casino. Spurback said even this emptiness marks progress: At least Milstein is tearing down the houses he bought instead of leaving them to rot. "They're trying to work with us and trying to understand that these are our neighborhoods," Spurback said. "And that even though they own them, we have to drive through them, we have to live adjacent to them every day."

When he takes the long view, Spurback said, he still has hope for his city. He concluded his tour not far from the development zone, at Olmsted's lush state park. Throngs of Asian tourists were walking down the path to the Terrapin Point overlook to the falls, where they stood and gawked at the water roaring over the precipice and tumbling into the roiling pool below. The mist caught the sun and made that famous rainbow. It reached up toward that tantalizing Canadian skyline, before dissipating into the air, a little short of prosperity. Ⓑ

"This used to be full of houses," Spurback said, driving into the dead zone under Milstein's control. "Even though they own them, we have to drive through them ... every day."

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Singing Songs of [Your Brand Here!]



Adam Kluger is a budding music mogul. His favorite song? That depends on who's buying.

By Burt Helm
Photographs by Peter van Agtmael

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Adam Kluger is in a hurry, and this Ford Explorer won't get out of the way of his Bentley. He's driving north from Miami to a music video shoot in Fort Lauderdale featuring both his new recording artist and his corporate client. It's 3 p.m. The shoot doesn't start until after 4, but still.

Kluger muscles his black coupé almost on top of the SUV's rear bumper. "The music industry's very laid back while I'm very, very aggressive," he says, clutching the wheel and his BlackBerry in a two-handed grip that lets him type and tailgate. He's 24, short, lean, and

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Prince (seated) with Kluger and JRandall (far right)



talks as fast as he's trying to drive. "I just need to get stuff done immediately."

In the past two years, Kluger has built a boutique agency that's become a conduit between the revenue-needy music business and a growing source of cash: consumer brands. Those who have seen the parade of products in Lady Gaga's *Telephone* video (table) have gotten a taste of The Kluger Agency's work. With a check and Kluger's help, products end up in music videos, lyrics, even song titles.

Kluger's newest project is managing a pop singer, an aspiring teen idol named JRandall. To build buzz, Kluger hired Grammy-winning singer T-Pain to appear in JRandall's video and sing a verse for the song, a dance track called *Can't Sleep*. Kluger's funding the music and video production both by the traditional method (with JRandall's label, Poe Boy Music Group) and with money from Zoosk, a dating website and one of his agency's clients.

Singers have name-checked brands since before Janis Joplin asked the Lord to buy her a Mercedes-Benz. But the practice of advertisers paying for a mention in songs has exploded. "I get calls on country, rock 'n' roll—today it's across the board, in every genre of music," says Brooke Wilson, head of music entertainment at The Marketing Arm, an agency that deals in endorsements. This year she got State Farm's logo into a video by rock band OK Go. "It's really started happening in the past 5 to 7 years. It comes down to the labels not having enough money and needing other avenues to promote themselves." Kluger's specialty is bringing product placement to niche brands and fledgling artists, not just big products and stars.

Approaching Ft. Lauderdale as *Can't Sleep* blasts through the Bentley's 1,100-watt speakers, Kluger talks about replicating JRandall, who got a placement deal before he released his first album. He wants to build a record label based entirely on brand dollars. He wants to party with his pals in the Ford Excursion stretch limo he just bought. There's so much to do, it hurts. "I call it my burning ambition," Kluger says, still riding the Explorer's exhaust pipe. "It literally pains me. Like, really pains me."

Before the cars and the rock stars, Kluger grew up in Tampa, the distractible son of a jeweler father and a mother in the apparel business. While other students sat attentively in class, Kluger doodled business ideas. After school hours he bounced around fast-food jobs and sold knives door-to-door. Childhood pal Joel Cardieri remembers the few weeks Kluger worked behind the counter at a local Boston Market. "He'd say things like, 'I'm not going to be here long. Something's going to happen soon, I feel it!'"

Kluger says he's always been obsessed with pop music. He recalls coming home from camp in 1999 with a song stuck in his head—*Summer Girls*, a bubblegum rap ditty with brand-conscious lyrics such as "I like girls that wear Abercrombie & Fitch." The song made him want to dance—and shop. "I was like, I gotta get Abercrombie & Fitch!" he says.

In 2006, after attending a two-year college in Gainesville, he moved to Los Angeles and enrolled in a for-profit vocational school to learn how to make it in music. As he sat through classes on royalties and audio engineering, he got a sense of just how much the recording industry was suffering. If it wasn't file-sharing sites obliterating CD sales, it was Apple tearing apart the album model by selling songs for 99¢. "No one was making any money," says Kluger. "And I was like, 'I like money.'"

The one music-business trend that caught Kluger's attention was product placement. Ever since Busta Rhymes' *Pass the Courvoisier* became a hit in 2002—causing sales of the cognac to shoot up—artists and marketers had awakened to the possibilities of "brand drops," to use Kluger's term. Kluger's thoughts drifted back to *Summer Girls*. How many kids felt the urge to shop at Abercrombie & Fitch after hearing that song, as he had? (Abercrombie & Fitch says it didn't pay for the mention.) Kluger says he quit the L.A. school after a semester and a half.

Beginning in early 2008, with no useful connections and a surplus of nerve, he started calling companies telling them he could place their brands in pop songs. Then he called the labels, telling them he could get brands to pay to be in their artists' songs. "There's a bit of bullsh-----g you have to do to get in the door," Kluger says.

In the summer of 2008, after "about 400" such calls, Kluger got a break. He reached the head of marketing for Interscope Records, Steve Berman, whom Kluger had heard of only because of his appearances on Eminem albums. (They had goofball skits where Berman would berate Eminem for recording vile, unmarketable music.) "Steve Berman said, 'I don't know about your company, I don't know about your brands, but I have a video,'" Kluger says. *Beautiful, Dirty, Rich* by a new artist named Lady Gaga, was going to shoot in just a few days.

Twelve hours later, Kluger signed his first client, Vixen's Visions, a maker of lingerie and "sexy club wear." The resulting placement was near the end

Kluger started by telling companies he could place their brands in songs; then he told record labels he could get them money for the exposure

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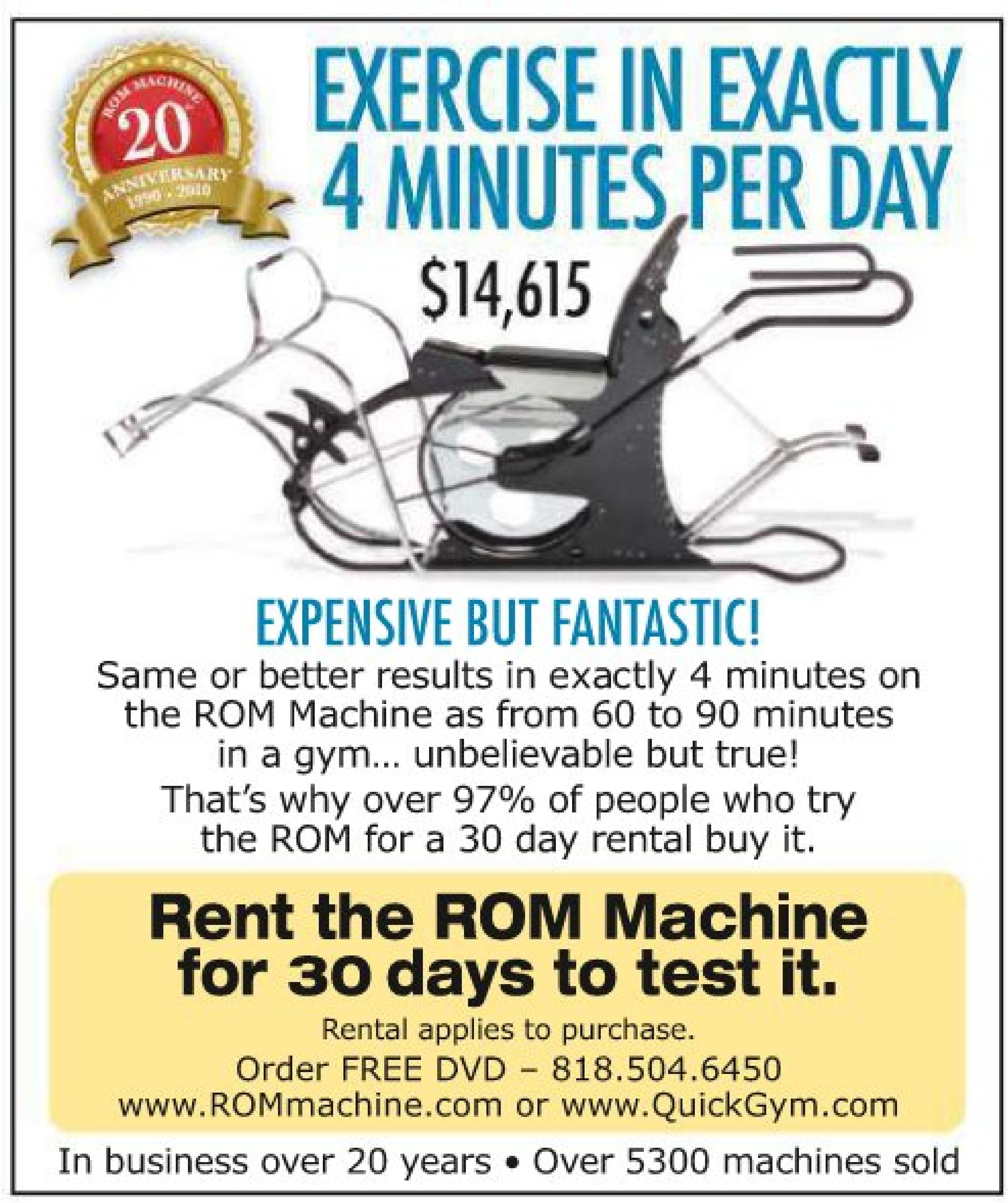
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Lady Gaga's *Telephone* Brand Parade



Kluger negotiated the Plentyoffish placement



Coca-Cola says it didn't pay to get the cans in Lady Gaga's hair



Virgin Mobile USA is the official sponsor of Lady Gaga's Monster Ball Tour



The headphones: Beats by Dr. Dre, a brand co-founded by her label's chairman, Jimmy Iovine

of the video as Gaga uses a Vixen's Visions shopping bag to dump cash on the floor. It was one second long. Kluger won't specify how much money changed hands in this or any ensuing deal, other than to say that his commission is up to 23 percent. According to clients, fees typically run between $40,000 and $250,000 per placement, depending on the artist. Getting a brand into song lyrics can fetch $500,000 and higher. (Berman did not return requests for comment; Vixen's Visions President Tony Paris Sr. says he's pleased with Kluger's work.)

Kluger quickly turned his Interscope relationship into a new deal. This time the product was Drank, a soft drink named after the slang term for a soda and codeine-cough-syrup concoction popular in the hip-hop scene. Multi-platinum superstar and Interscope artist Lil Wayne often rapped about the latter beverage. Kluger approached Drank founder Peter Bianchi about getting the non-narcotic Drank into music videos by Lil Wayne and other Interscope talent. Bianchi says he liked the idea and signed a multi-video contract.

Kluger celebrated by taking a month-long cross-country trip from L.A. to Florida in a Mercedes SL500 convertible. He was so happy to be back with his old high school friends in Tampa, he decided to move his business to Miami, just a few hours' drive away.

By April 2009, Kluger landed a Drank placement in the video for *Sugar* by Flo Rida. At the shoot, Kluger met Elric "E-Class" Prince, the chief executive of Poe Boy, Flo Rida's label. Prince had just received an object lesson in the power of product placement. The previous summer, Flo Rida had a smash hit, *Low*, which mentions Apple Bottom Jeans, Reebok, Cadillac, Rémy Martin and Hennessy cognacs, and Patrón tequila. Another hit, *Forever*, by R&B singer Chris Brown, had the line "Double your pleasure, double your fun," the old Wrigley's Doublemint gum jingle. Crucial difference: Brown had a multimillion-dollar endorsement deal with Wrigley; Flo Rida recited his favorite consumer goods gratis. "Never again," says Prince.

Kluger's relationship with Prince has evolved into a sort of "marriage," as Prince puts it. Kluger brings brand prospects to Prince; Prince gives Kluger access to artists and managers on the Poe Boy label and throughout the industry. Earlier this year, Flo Rida and T-Pain recorded a song called *Zoosk Girl*, about the attractive women they meet on Zoosk. Prince, meanwhile, asked Kluger to manage JRandall, a singer from Delray Beach he had recently signed.

Kluger says he'll reach $5 million in revenue this year. In March he secured an investment from Hadley Capital, a private equity firm in Wilmette, Ill. He used the funds to hire a four-person sales staff and lease a 3,000-square-foot office in downtown Miami. Then he got himself an Aston Martin Vantage convertible.

On the set of the *Can't Sleep* video, Kluger paces as JRandall puts on his first costume, a sexy fireman's outfit. Like pop star Justin Bieber, Kluger's 23-year-old talent has dreamy hair and elfin good looks. But the lyrics of JRandall, who played a lifeguard last summer on a late-night cable series called *Beach Heat: Miami*, are more overtly sexual than Bieber's. Kluger hopes teenyboppers "hop on the J Train" as they get older, he says.

The shoot is inside the Sawgrass Mills mall near Ft. Lauderdale at a kid-friendly attraction called Wannado City, complete with a mini-courthouse, carnival, fire truck, and a building that looks like it is on fire. The concept of the *Can't Sleep* video is an homage to *Little Monsters*, the 1989 comedy in which a monster under the bed befriends a little boy. In this version, JRandall befriends a girl—who's up late surfing zoosk.com—and whisks her away to an underworld, played by Wannado City and a lot of smoke machines. According to Kluger, Zoosk paid "in the mid- to high six figures" to appear in the lyrics and video for *Can't Sleep*, and one other JRandall song, *Oo La La*. (Zoosk declined to comment.)

The Zoosk fee more than covers the production costs for both videos, and Kluger is lining up other brands, too. He tells JRandall that a prospective sponsor for the *Oo La La* video will be on hand.

"It's a cream liquor," says Kluger.

Randall stops picking through a tableful of sunglasses. "Cream liquor? But I'm allergic to dairy."

"It doesn't matter, you'll love it!" Kluger replies.

Between takes, Kluger pumps his fist and yells "I'm Zooskin' For Love!" (a line in the song). Just as the burning-building scene wraps, Prince gets a message on his phone. T-Pain has arrived.

Stars such as T-Pain, who's had nine songs on Billboard's Hot 100, are a core part of Kluger and Prince's marketing strategy. The addition of T-Pain's trademark auto-tuned voice (he sounds like a singing robot) will ensure that JRandall's single gets lots of radio play and YouTube views. (The other single, *Oo La La*, has a guest appearance by another star, Akon.) Kluger and Prince managed to get T-Pain because Flo Rida had worked with him before, and Kluger arranged a placement deal for one of T-Pain's budding artists. To seal the deal, says Kluger, "E-Class bought him a watch."

As T-Pain, wearing a tracksuit and a necklace bearing a ruby-and-diamond-encrusted Kool-Aid Man, gets ready for his close-up, Kluger turns his attention behind the camera. Chris Hansen, one of his salespeople, has brought in the prospect from Cream, the "cream liquor" (actually a 30-proof whipped cream). Hansen is telling the Cream guy, who looks starstruck, "You can get the big star for the up-and-coming-artist price!" It's a good pitch. And it seems to work. "There's no better way to get your brand out there," the prospect says, staring at T-Pain.

Kluger breaks into a grin. Ⓑ

YOUTUBE (4)

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ADVERTISEMENT

South Korea:
Greener, smarter and more colourful

South Korean companies are improving the quality of people's lives with greener, cleaner technologies





Above: Chunggyecheon Stream: a major success in sustainable urban development; Left: Supersized plasma display panels in the Korea Pavilion at Expo Shanghai 2010

As South Korean industries pursue quality over mere output, companies are asking themselves the question: "Would it improve the quality of life for our users if the product was created with a mind towards being friendlier, greener, smarter and more colorful?"

In an attempt to redefine innovation in product development, South Korean companies are increasingly aiming at creating technologies that improve the quality of people's lives.

With the highest broadband penetration in the Asia-Pacific region, and ranked No.7 globally, South Korea is an ideal place for technology companies such as Samsung to trial key products before their global release – a perfect test-bed for green work concepts such as tele-working and video conferencing that create opportunities for South Korea to be at the forefront of the information and communication technology (ITC) revolution.

South Korea is not only interested in making industry greener; it is also providing the technology that will make for a greener world.

South Korea is a world leader in the field of renewable energy. Solar cell production reaches one gigawatt per year at the end of 2009 and companies such as LG and Samsung have already moved ahead and begun production of crystalline silicon cells and modules, providing a vital motor force to the nascent industry.

LG Chem, South Korea's largest chemical company, meanwhile, is making a big impact on the global auto industry by producing electric car batteries. Extending its chemical expertise into high-tech areas, it has been securing contracts to supply lithium-ion polymer batteries with GM and Renault as well as with Korean automakers such as Hyundai and Kia.

Hyundai Motor Co. recently unveiled the company's and South Korea's first Full Speed Electric Vehicle (FSEV) named 'BlueOn,' opening a new era in eco-friendly technology. BlueOn boasts a maximum speed of 130km per hour and can reach 100km per hour in just 13.1 seconds, better than some petrol-driven models in the same class. It can travel as far as 140km on a single charge. It also accommodates dual recharging methods: 220V household power and a 380V industrial-strength power, which promises quick recharging speeds. Using household power, the battery can be fully recharged within six hours. Under the quick charge method, however, the battery can be recharged to about 80 per cent of its capacity within 25 minutes.

Hyundai is planning to provide 30 BlueOn vehicles as test fleets to various government organisations in South Korea, promoting the country's eco-friendly image at the upcoming G20 summit.

Coupled with these innovations, South Korea's hopes for a green future also hinge on the use and production of high density memory in semiconductors, bringing significant power savings to data centers, server systems and high-end laptops. Samsung Electronics has begun mass producing the industry's first low-power four gigabyte DDR3 devices using 40 nanometer class process technology. Samsung Electronics and Hynix, currently ranked first and second respectively in global market share in the DRAM market, together dominate the sector with 54.1 per cent global share.

Adding colour to consumers' lives has been a byword for the South Korean display industry since it rose from relative obscurity just a few short decades ago to its dominant position in the world market today. It was one of the few sectors to survive the downturn with ease, recording a continuous surplus up to 2009. The LCD Big 2s, Samsung and LG's combined took more than 50 per cent of the global LCD market share.

As Korean industries perfect their products, cutting edge technologies are continuing to find friendly, smart, green and colorful solutions that improve the quality of life for users around the world.

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What to do when you're grounded. Page 96

Airport Hell & Koshermania & Online Art

Etc.

Stanley McChrystal drinks Bud Light Lime. The brewer's marketing hits and misses. Page 103





The Sick-Day Bounty Hunters

As an alarming number of workers play hooky, corporations are clamping down—and calling in the detectives. *By Eric Spitznagel*

Illustration by Marcos Chin

MCCHRYSTAL: J. SCOTT APPLEWHITE/AP PHOTO

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Etc. Hooky Detectives

Rick Raymond parked his black Kia SUV behind a row of trees and peered out at his target. It was 4 a.m. on a recent morning, and Raymond—a seasoned private detective who has worked roughly 300 cases, from thieves to philandering spouses—was closing in on a different sort of prey. Recently, Raymond has come to occupy a new and expanding niche in the surveillance universe. Corporations pay him to spy on workers who take "sick days" when they may not, in fact, be sick. Such suspicion has led Raymond to bowling alleys, pro football games, weddings, and even funerals. On this morning it has taken him to a field outside the home of an Orlando repairman whose employer is doubtful about his slow recovery from a car accident. Although Raymond tries to be impartial about his subjects, "80 to 85 percent of the time," he says, "there's definitely fraud happening."

Playing hooky without getting caught—as immortalized in the cat-and-mouse skirmish between Ferris Bueller and Principal Rooney in *Ferris Bueller's Day Off*—used to be an adolescent rite of passage. Now it has given rise to a thriving industry, with stern legal precedent to back it up. In 2008, Raybestos Products, a car parts manufacturer in Crawfordsville, Ind., hired an off-duty police officer to track an employee suspected of abusing her paid medical leave. When the employee, Diana Vail, was fired after the cop produced substantial evidence that she was exploiting her benefits, she sued Raybestos. In what became the landmark case for corporate snooping, the 7th U.S. Circuit Court of Appeals dismissed her lawsuit. A panel of judges declared that while surveillance "may not be preferred employer behavior," it wasn't unlawful. According to Susan W. Kline, a partner at the Baker & Daniels law firm in Indianapolis, the case "encouraged [companies] to consider hiring their own private detectives." It also set a precedent, she says, that "reasonable suspicion" is sufficient justification for employer spying.

57 percent of U.S. employees are taking sick days when they're not actually sick

Ferris Bueller, the Che Guevara of hooky players, and his nemesis, Ed Rooney



Such techniques have become permissible at a time when workers are more likely to play hooky. Kronos, a workforce productivity firm in Chelmsford, Mass., recently found that 57 percent of U.S. salaried employees take sick days when they're not really sick—a nearly 20 percent increase from statistics gathered between 2006 and 2008. Taking such risks amid an economic meltdown, suggests Kronos Senior Director Joyce Maroney, has less to do with foolish confidence than a general lack of enthusiasm for work. "People are staying in jobs they don't like because of a fear that there won't be another job out there," she says. "With less job satisfaction, there's a greater propensity for sick-time abuse."

That's great news for the corporate surveillance business. Alliance Worldwide Investigative Group, a private investigation firm in Clifton Park, N.Y., with experience in corporate sleuthing, charges $75 per hour per investigator. And those hours add up. According to Alliance Chief Executive Officer and founder Mario Pecoraro Jr., successful surveillance requires establishing a pattern of activity that, he says, "can sometimes require multiple days, or even weeks."

Perhaps this is because workers have become increasingly inventive with their sick-day tomfoolery. This summer, Middletown (Pa.) schoolteacher Leslie Herneisey—a three-time Teacher of the Year nominee—was arrested and charged with lying to colleagues about having an inoperable brain tumor so she could take extended sick leave. In 2009 four firefighters in Haverhill, Mass., were suspended after a private investigator, hired by the mayor, caught them attending hockey games and engaging in other blatantly non-sick-day activities.

They are not alone in their ambition. Earlier this year, Raymond investigated an employee at a Florida health organization who called in sick with the flu for three days. As Raymond discovered, she was actually visiting the Universal Studios theme park. "On some of those roller coasters, they take your picture at a really sharp turn, and then you can buy it at a kiosk," Raymond recalls. "She went on three rides, and I bought all three of her pictures, which had the date at the bottom." When confronted with the evidence by her employers, Raymond says her first response was, "That's not me!" After they played Raymond's video of her volunteering at the theme park's animal show, her only defense was, "I don't even remember that!" She was fired.

While some employees may be less engaged in their jobs, many are increasingly interested in new and creative ways to get out of work. "It's all about technology these days," says Frank M. Ahearn, a New York-based equal opportunity "privacy consultant" who has helped employers "catch people who were supposed to be at work" and advised others on eluding their bosses. "If you understand how to use technology effectively, you can appear to be anywhere,"

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Missing Persons

No matter the business, every manager has to deal with self-serving employees capable of slacking off or deception. Sometimes, though, it's the top dog who's playing hooky—or just asleep at the wheel. *By Neil Janowitz*

George W. Bush
Former President, brush-clearing enthusiast
During two terms, Bush spent 487 days at Camp David and 490 at his Crawford ranch. One-third of his Presidency was thus spent "working from home."

Lindsay Lohan
Delinquent actress
After she often no-showed during the shoot of 2007's *Georgia Rules*, the CEO of production company Morgan Creek sent a letter chastising her for such lame excuses as "heat exhaustion."

Manny Ramirez
MLB superstar
Playing for the Red Sox in 2003, he was out sick during a series against the Yankees. Though not sick enough to stop him from socializing with the Pinstripes' Enrique Wilson at the Boston Ritz-Carlton bar.

Jimmy Cayne
Former CEO, Bear Stearns
The Bridge Grand Master famously departed for a tournament as his firm—and its nearly $400 billion in assets—flirted with bankruptcy and sent Wall Street into chaos.

Jack Phillips and Harold Bride
Radio operators, Titanic
The duo were tasked with handling radio messages for the ship's 2,220-plus passengers. Unfortunately, they didn't heed significant iceberg warnings.



OPPOSITE PAGE: PARAMOUNT/KOBAL COLLECTION; THIS PAGE, FROM LEFT: TIM SLOAN/AFP/GETTY IMAGES; JEAN BAPTISTE LACROIX/GETTY IMAGES; TODD OLSZEWSKI/GETTY IMAGES; KEVIN LAMARQUE/REUTERS; CENTRAL PRESS/GETTY IMAGES

he says. Ahearn once had a client who issued each of his employees a cellphone with a GPS tracking system. "He thought it was foolproof," Ahearn says. That was until the boss learned one employee had FedExed his phone to a hotel where he was supposed to be staying on a business trip. Instead, the worker opted for an exotic vacation. "It's a duel between bosses and their employees," Ahearn says. "Whoever has better technology usually wins."

One popular toy among the adult Ferris Bueller set is the SpoofCard. Sold on the Internet by Toms River (N.J.)-based TelTech Systems, a SpoofCard allows users to select any 10-digit number to appear on the phone of the person they're calling. When their customer calls in sick, the boss will see this number on the caller ID and assume the employee is at home in bed when he may actually be on line at the Matterhorn, or on the beach in Hawaii. Meir Cohen, president of TelTech Systems, insists SpoofCards don't pose any ethical dilemma. "We've had people misuse the technology occasionally for illegal purposes," he says, "but the majority of people use it to protect their privacy. If you have a boss that's prying into your personal life, this is a great tool."

Cohen also offers a chance to offset the SpoofCard with a new TelTech product, LiarCard, which uses voice analysis to determine if a caller is being dishonest. "We have companies that use the LiarCard for HR purposes," he says, "to find out if their employees are lying to them." Cohen doesn't mind selling a service to one customer that's designed to entrap another. "We want to help everyone," he says.

"It's a duel between bosses and their employees. Whoever has better technology wins"

Cohen may have a point—sometimes even corporate surveillance experts need watching. When he was working as a training director for a large detective firm, Rick Raymond once sent a rookie investigator and a seasoned veteran out on a routine job. Instead, the two opted to get drunk and watch football at a nearby Outback Steakhouse. Later that day, a secretary from Raymond's firm went to lunch at the same Outback and witnessed both detectives drinking beers and eating cheese fries. "They were there before she showed up," he says, "and they were still there, watching football and drinking beer, two hours later." When the pair submitted their surveillance logs for the week, both failed to mention their afternoon-long repast. Both were immediately fired.

As the sun rises over Orlando, Raymond's still sitting in his SUV, watching his repairman. He's now come to appreciate the employer-employee relationship. "I remember one worker who created an elaborate hoax to go on a cruise when he was supposed to be sick," Raymond says. "When he was shown the video surveillance I'd done, he actually said to his boss, 'I can't believe you'd be so sneaky.' The hypocrisy is amazing!" And it's great for business.

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The (Airport) Nightmare Before Christmas

Don't let an extended travel delay ruin your vacation. Avoid terminal hell and take in these

New Jersey's Newark Liberty International





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Dallas Fort Worth International





Head 20 minutes south to Arlington, home of the new **Cowboys Stadium** (900 E. Randol Mill Rd.). Sign up for a VIP tour ($27.50) of the venue, which gives you a peek at the locker rooms, press boxes, and artwork from the art collection that decorates the $1.2 billion stadium's walls. Arlington is also home to **Potager Cafe** (315 S. Mesquite St.). Slow Food apostle Cynthia Chippindale serves locally sourced, home-cooked food. Prices are suggested, but it's up to patrons to determine the meal's worth.

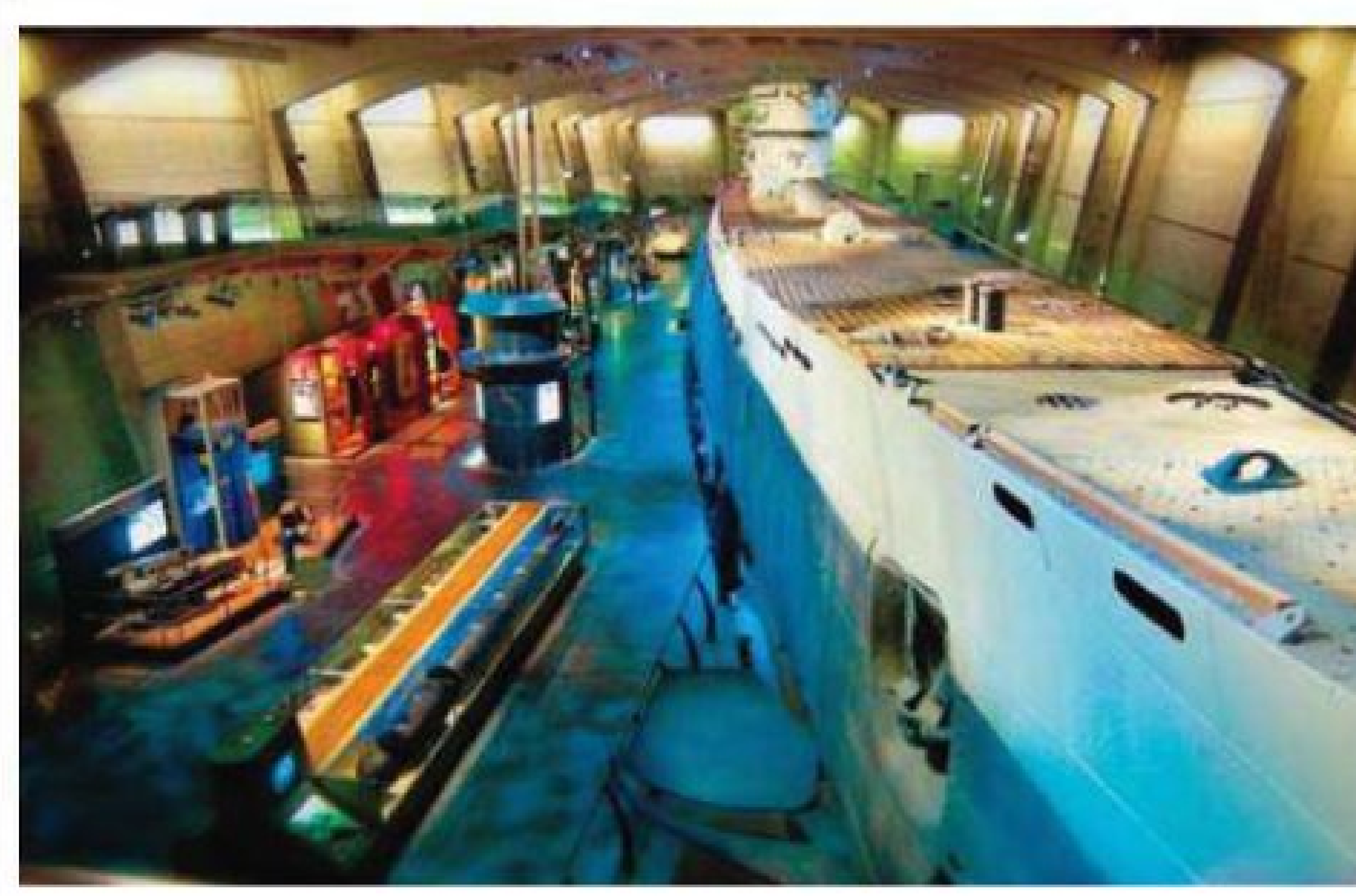
San Francisco International





Coyote Point Recreation Area (1701 Coyote Point Dr., San Mateo), a 670-acre complex with hiking trails, beaches, and a wildlife museum, is an eight-minute drive south from SFO. Take a jog on the beach, where you can watch windsurfers and kayakers set against views of San Francisco. On the way back to the airport, stop at **In-N-Out Burger** (11 Rollins Rd., Millbrae). Splurge on a $3.32 double-double—that's a two-patty burger, you East Coast philistines. It beats anything at the SFO food court.

Chicago's Midway International





From Midway, it's a 20-minute drive east to Frank Lloyd Wright's Prairie School-style **Robie House** ($15; 5757 South Woodlawn Ave., Chicago). From there, tour the **Museum of Science and Industry** ($20.95; 5700 South Lake Shore Dr.), home to objects such as the world's largest pinball machine. Try nearby New Orleans-style restaurant the **Big Easy** (1660 East 55th St.). It serves a selection of microbrews that you won't find at an airport watering hole.

Sky Mall Alternatives

Don't let a grounded flight affect holiday shopping. Purchase presents before pushback at these airport boutiques.



SFMOMA MUSEUMSTORE, SAN FRANCISCO INTERNATIONAL
Located in the airport's Main Hall, this shop has everything from stocking stuffers to a $242 beaded glass necklace. Proceeds benefit SFMOMA.

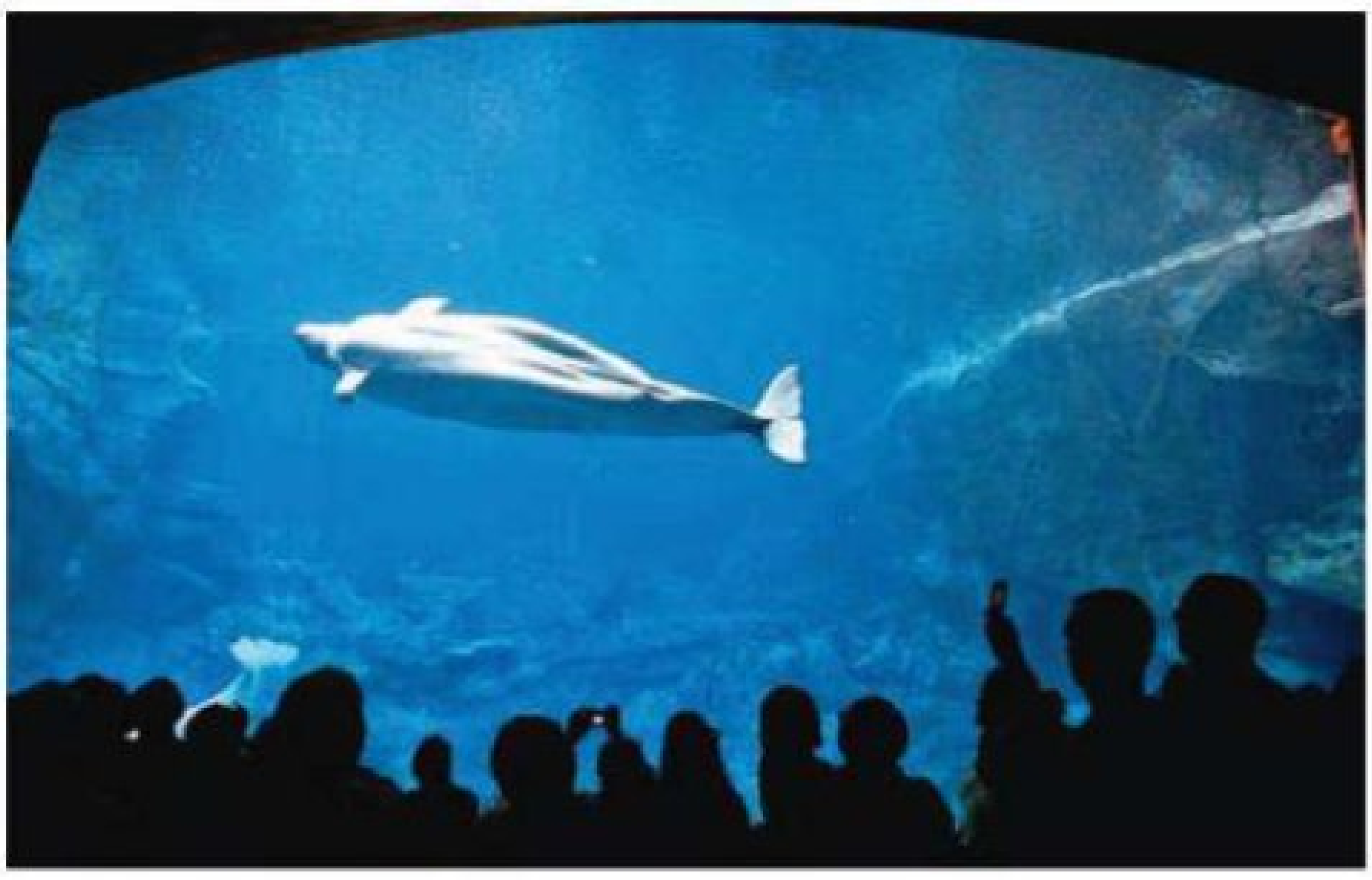
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nearby attractions. *By Geraldine Campbell*

Hartsfield-Jackson Atlanta International

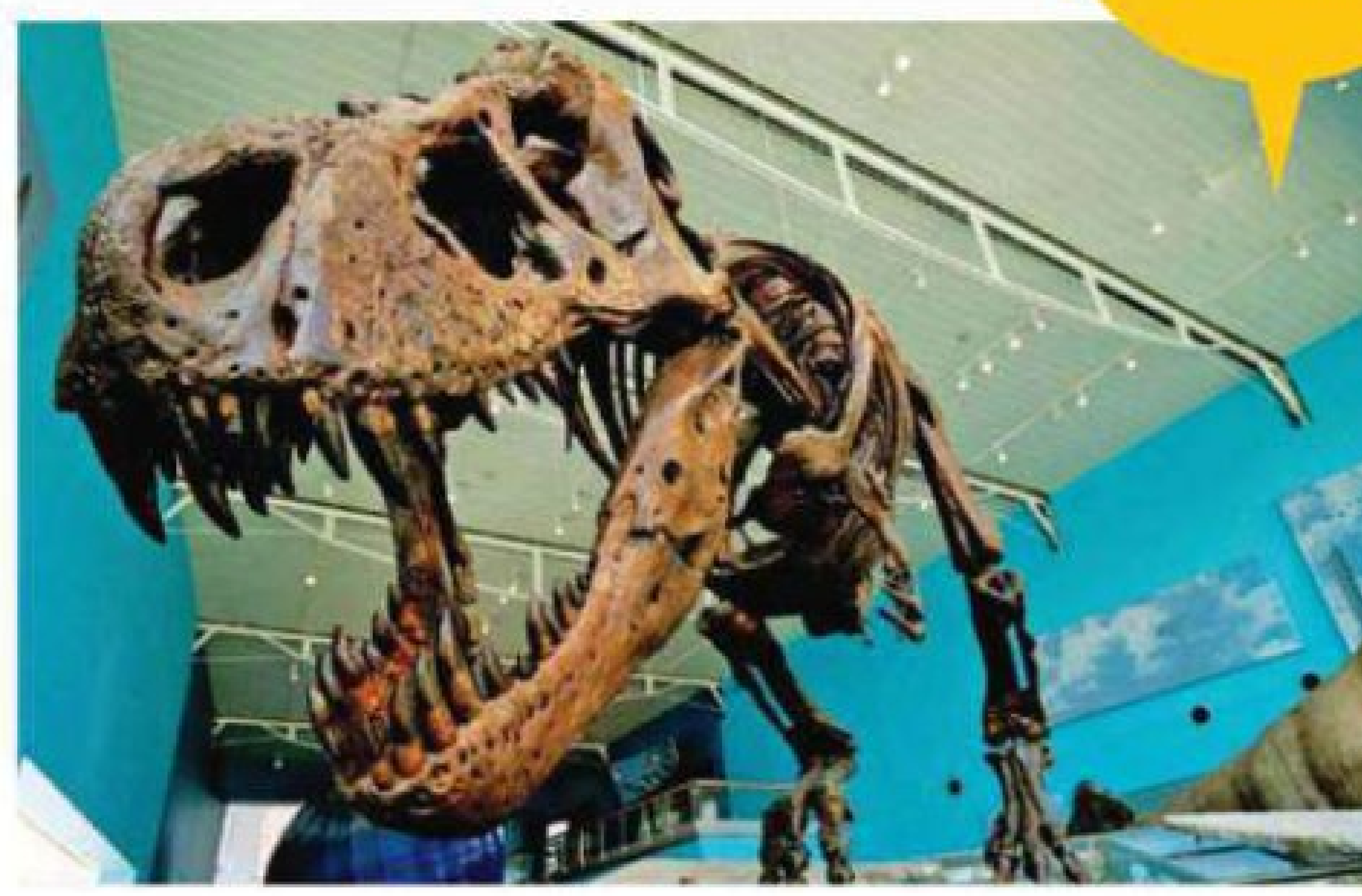


Hop on the MARTA, Atlanta's commuter railway, for a 16-minute ride to the **Georgia Aquarium** ($26; 225 Baker St. NW). With 8 million gallons of water and more than 100,000 species of marine life—including 77 live sharks—it's the world's largest aquarium. Close by, take a behind-the-scenes tour of another "world's largest," the **CNN Center** ($13; 1 CNN Center), which houses the network's newsroom. Afterwards, grab a fried shrimp po' boy ($13) at **Glenn's Kitchen** (110 Marietta St.).

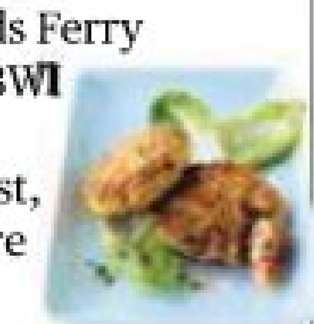


Baltimore-Washington International

Play paleontologist at the Maryland Science Center's Dinosaur Mysteries Exhibition



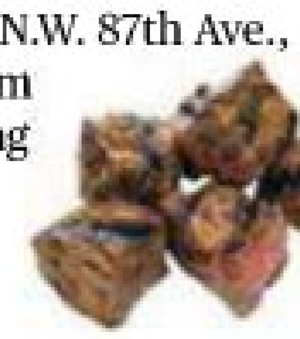
To know real crab cakes, you must eat them in Maryland. You can get great ones two miles from the airport at **G&M Restaurant** (804 Hammonds Ferry Rd., Linthicum Heights), but a better bet is going 20 minutes east of BWI to **Faidley Seafood** (203 North Paca St., Baltimore). This Lexington Market spot has the chunkiest crab cakes ($13) in town—or, some attest, in the world. Later, head to Baltimore's touristy **Inner Harbor**, where the **Maryland Science Center** ($13; 601 Light St.) is located.



Miami International



Delayed travelers may not have time to play nine holes on one of the five championship golf courses at **Doral Golf Resort and Spa** (4400 N.W. 87th Ave., Miami). However, the complex—just a 12-minute taxi ride west from the airport—allows antsy travelers another relaxant: Doral's driving range has an unlimited-balls policy. The resort also has a 52,000 square-foot spa, where you can book a 50-minute citrus-mango scrub ($130), and a new Latin-themed steakhouse, **Mesazul**.



Detroit Metro



You can explore automobile history at the **Henry Ford Museum** in suburban Dearborn ($15; 20900 Oakwood Blvd.), just 16 minutes from the airport. The collection includes the Rosa Parks bus and President John F. Kennedy's limo. Tour the Ford Rouge Factory, where the company has been making cars since 1917. Dearborn is also home to the **Arab American National Museum** (13624 Michigan Ave.)—and fantastic baba ghanoush at **Al-Ameer** (12710 West Warren Ave.).





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Etc. Food

This year's Kosherfest drew traditional purveyors and Canadian hemp oil brands alike







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Livin' Off a Prayer

As the kosher food market grows, the certification business is exploding. *By David Sax*

The throng inside the Meadowlands Exposition Center–Israeli women in long skirts, Hasidim in floor-length coats, Wal-Mart buyers in Dockers–might have struck some as the casting call for a Mel Brooks movie. However, the crowd had come to Secaucus, N.J., in late October for the annual extravaganza known as Kosherfest, a two-day trade show connecting kosher food buyers and sellers from across the globe. Though the event is still dominated by marquee brands of High Holidays past–Empire Kosher chicken, Streit's matzos, Gold's horseradish–a swarm of rabbis mobbed booths featuring the latest converts to the rapidly expanding world of kosher food: frozen spring rolls, Canadian hemp oil, Glenmorangie Scotch, and Ed Hardy tequila in an ornately decorated bottle with a skull stopper.

Thirty years ago there were 18 kosher certification agencies. Now there are 1,063

Kosher was once a set of rules that Jews observed primarily in the home. Meat was ritually slaughtered by local rabbis, bread was bought from kosher bakeries, and everything was cooked according to the Biblical laws of *kashrut*. As processed and packaged foods replaced homemade matzo balls, though, kosher consumers began to demand more variety. Starting in the 1930s, brands such as Coca-Cola have increasingly obliged by pursuing kosher certification agencies to bestow their products with a *hechsher*, or stamp of approval. Now the kosher retail market, which represents upwards of $13 billion in annual sales, according to Brooklyn (N.Y.) marketing firm Lubicom, even includes certain foods–such as chocolate Easter bunnies–that many Jews might never eat. Says Sue Fishkoff, author of *Kosher Nation*: "Today, one-third to one-half of the

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food in a typical American supermarket is kosher."

The business of becoming kosher remains tightly regulated by certification agencies. Such groups are built around the work of a *mashgiach*—a hybrid of a Talmudic scholar and a Food and Drug Administration inspector who supervises food production to ensure everything is kosher. That means overseeing the slaughter and cooking processes of meat and fish, ascertaining that each ingredient entering a plant is inscribed with the *hechsher*, and keeping kosher food production separate from that of non-kosher food.

As the desire for kosher products has grown, so has the *mashgiach* business. "The number of certification agencies has exploded," says Rabbi Yosef Wikler, editor of Brooklyn-based *Kashrus Magazine*, which tracks the kosher certification industry. "Thirty years ago there were 18, but now there are 1,063 kosher certification organizations around the world. In America alone there are 600." Wikler estimates the U.S. kosher certification business is now a $200 million-a-year industry.

At the top of the kosher food chain is Manhattan-based Orthodox Union (OU), a *kashrut* powerhouse that supervises and certifies production in more than 6,000 plants in 77 countries. It employs 75 full-time *mashgichim* and a small army of advising rabbis. While the OU's stamp appears on everything from AriZona Iced Tea drinks to Nabisco cookies and Tootsie Roll candies, its real growth comes from the phenomenon of trickle-down koshernomics. An ingredient supplier hoping for a contract with a kosher-certified Big Food outfit must first submit to the strictures of *kashrut*. "It's a domino effect," says Rabbi Moshe Elefant, OU's executive rabbinic coordinator and chief operating officer. "When you have Pillsbury or General Mills going kosher, you're talking about thousands of ingredients made by hundreds of companies in thousands of plants, each of which needs to be certified."

The process doesn't come cheap. Companies that make a single product with an approved list of kosher-certified ingredients require only a few inspections per year. Factories that make both kosher and nonkosher products in the same plant—or those that develop new products from numerous ingredients—require extra supervision. This can involve weekly or even daily inspections that drive annual costs into the hundreds of thousands. Brooklyn's OK Kosher, OU's fiercest competitor, certifies 20 new companies each week, many of which are ingredient producers. Rabbi Chaim Fogelman, a spokesman for OK Kosher, estimates the agency is growing at around 15 percent annually.

As a result, supermarket shelves now groan under the weight of kosher offerings. A recent addition, James Tea, a maker of tea concentrates

Agencies now vie to certify everything from canned tuna in the Philippines to packaged olives in Egypt

in Painesville, Ohio, converted this fall after being courted by a kosher-certified whiskey brand to make an alcoholic tea. Faced with the choice to certify his own product or risk losing the business, James Tea owner James Kekelis paid Cleveland Kosher just over $2,000 for a *hechsher* and rushed to open a booth at Kosherfest.

As the food industry's supply lines have spread globally, the business of kosher certification has followed the diaspora. Kosher agencies currently compete to certify artificial flavors in Thailand, canned tuna in the Philippines, packaged olives in Egypt, and a staggering number of additives in China. "Picture the sight of one of our rabbis riding up a Tibetan mountainside on a donkey," says Rabbi Menachem Genack, OU's chief executive officer. "Why's he there? Because there was a shortage of casein—a milk-derived protein used in processed foods. Someone was extracting the protein from yak milk in Tibet, and we had to be there to certify it!"

Those in charge of kosher certification point out that, despite the industry's growth, most organizations remain nonprofit. While 90 percent of OU's funding comes from kosher certification fees, profits are funneled back into community organizations. "Kosher agencies aren't making billions," says Rabbi Elefant, holding up the lapels of his rumpled suit. "If we were making billions, I wouldn't look the way I look." Ⓑ


Coca-Cola has been certified kosher since the 1930s


All Nabisco products and their ingredients are kosher


Empire Kosher, a historic Orthodox Union client



A representative for Klein's, the perennial kosher ice cream power



Tootsie Rolls are among the many candies bearing the *hechsher*



Ed Hardy tequila is new to the tribe

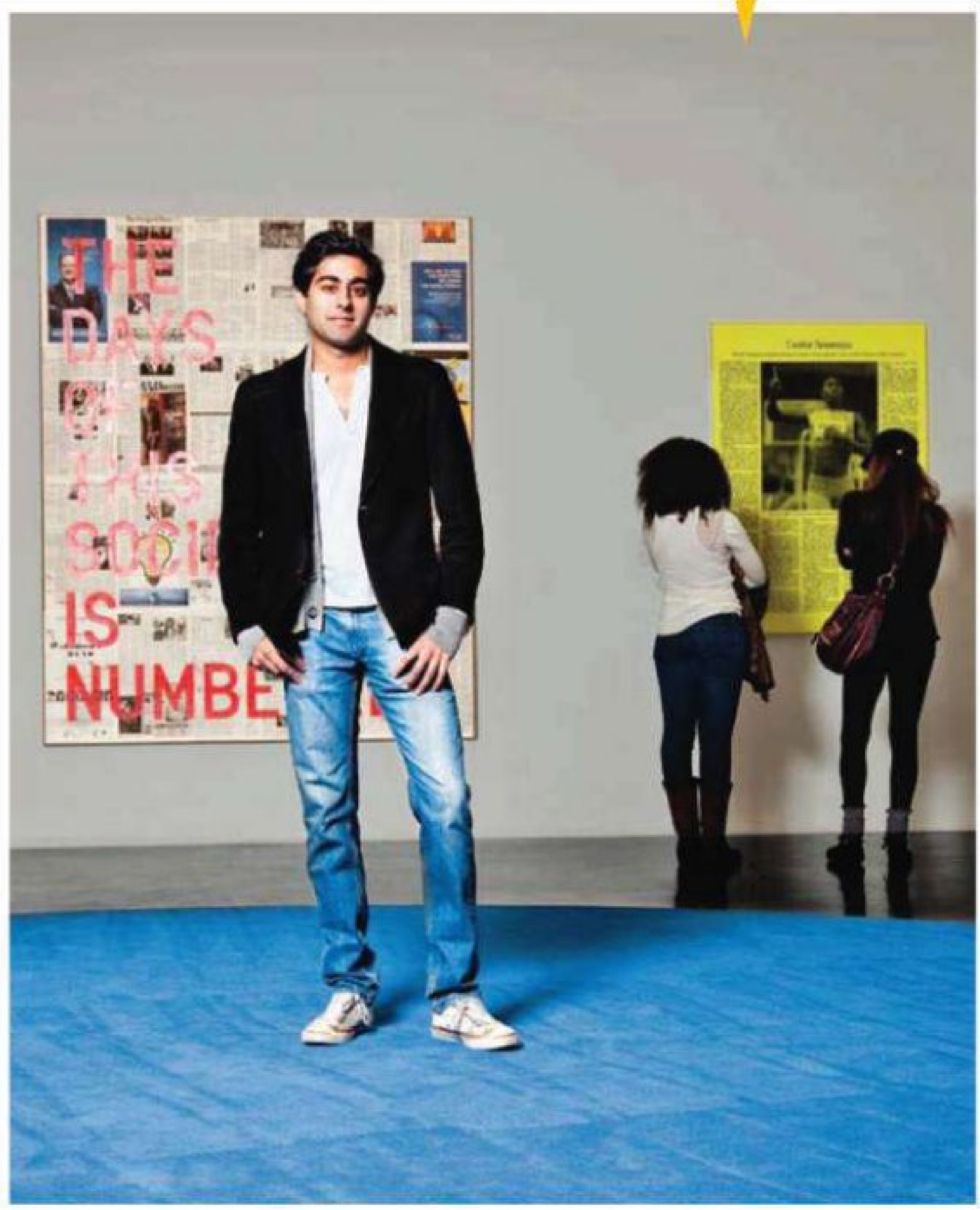
KOSHERFEST: PHOTOGRAPHS BY JEFF MERMELSTEIN FOR BLOOMBERG BUSINESSWEEK; OREO: DAVID DE STEFANO/GETTY IMAGES; CHICKEN: RYAN HARVEY/GETTY IMAGES

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Art for the Internet's Sake

Former investment banker Manish Vora is attempting to streamline the art market on the Web



Manish Vora left finance for a niche in the art market—and it's working. *By Alexandra Wolfe*

Manish Vora had wanted to be an entrepreneur ever since he attended Yale University during the dot-com boom. "I never dreamed of being an investment banker," he says. Then the tech bubble burst, and Wall Street beckoned. For two years, Vora, 30, labored over power and energy deals at Citigroup in New York before joining Monness, Crespi, Hardt & Co., an equity research firm in Manhattan. His job as head of research had him logging 60-hour weeks, not counting time spent on corporate entertaining.

While escorting his high-net-worth clients to art fairs and openings, Vora realized there wasn't a good Web resource for collectors to track pieces or aggregate sale and auction data. That got him thinking "of creating a tech company that made art more successful online." In 2007 he and a Web designer, Dylan Fareed, invested a combined $10,000 and launched Artlog, a website that provides collectors with comprehensive global listings of pieces, gallery and museum events, and recent sales. When Vora gave notice at the research firm in January 2008, Neil Crespi, his boss, decided to invest in the startup. "I like the way he thinks," says Crespi, who initially let Vora operate Artlog out of the firm's office.

Without taking salaries, the co-founders focused on marketing. In June 2008 they hosted a party with New York's New Museum during which 29 galleries signed up to list sales and exhibitions on the site. This fall the company—which charges for events—formed an association with American Express to provide advisory services for select cardholders. While Artlog doesn't take commissions from the sale of pieces listed on its site, Vora plans to start charging a $150 monthly fee for art professionals to take advantage of certain analytic functions. In the meantime, more than 4,000 galleries and museums list on the site.

Now based out of an office on Manhattan's Park Avenue South, Artlog has 13 paid employees—including its founders—and hopes to break even by early 2011. "As Artlog becomes an increasingly valuable tool for collectors," says Ben Sontheimer, an investor and chief executive officer of New York hedge fund Vault Partners, "the fragmented secondary art market will be a lucrative area." Ⓑ

Dancing Pear, by the artist Parra, is one of Artlog's thousands of listings



CURATING A BUSINESS

300,000
Monthly page views on Artlog, a digital hub for real-time information on art events and sales

10,000
Total attendees at Artlog's off-line events, such as gallery openings and art fair parties

90%
The salary hit Vora took after leaving finance to start his online art venture

10
Days per month that Vora spends gallery-hopping around New York City

DATA: ARTLOG

VORA: PHOTOGRAPH BY ERIN PATRICE O'BRIEN FOR BLOOMBERG BUSINESSWEEK

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Etc. One True Thing

The All-Weather Boot

Ilse Jacobsen's rain boots are also available in black, blue, pink, and Army green–and in varying heights



Don't let the rain or snow cramp your style on the way to work

The Want: Stylish winter boots that'll keep you dry to and from the office. They should be practical, warm, and have good traction–and they shouldn't make you look like Bob Vila.

The Get: Ilse Jacobsen's tall rain boots ($189 at madewell.com). These seamless Danish-designed galoshes are handmade from waterproof natural rubber, which is surprisingly breathable and flexible. Nothing should slosh over their knee-high tops and the rubber sole will prevent you from slipping. The attached tongue keeps water out and the cotton fleece lining keeps toes toasty even when the temperature drops. Ⓑ —*Meredith Stebbins*

EXTREMITY MAKEOVER

An arsenal of this season's winter accessories



Head

Don't want to sacrifice your coif to a hat? Throw on a pair of Ugg Cardy Earmuffs instead. The outside stitch pattern is understated, and the shearling sheepskin lining is the Australian company's trademark. *$75 at uggaustralia.com*



Feet

Prevent cold feet by pairing your Wellies with J. Crew's warm Camp Socks, which are knit at Vermont's last remaining sock mill. The classic ragg marl yarn socks come in colors ranging from orange to light gray and navy. *$12.50 at jcrew.com.*



Hands

Warm your fingers with Kenneth Cole's Leather Gloves. Available in four colors, these sophisticated gloves look like a regular pair of winter mitts but come with the added benefit of a soft, 100 percent cashmere lining. *$78 at kennethcole.com.*



Neck

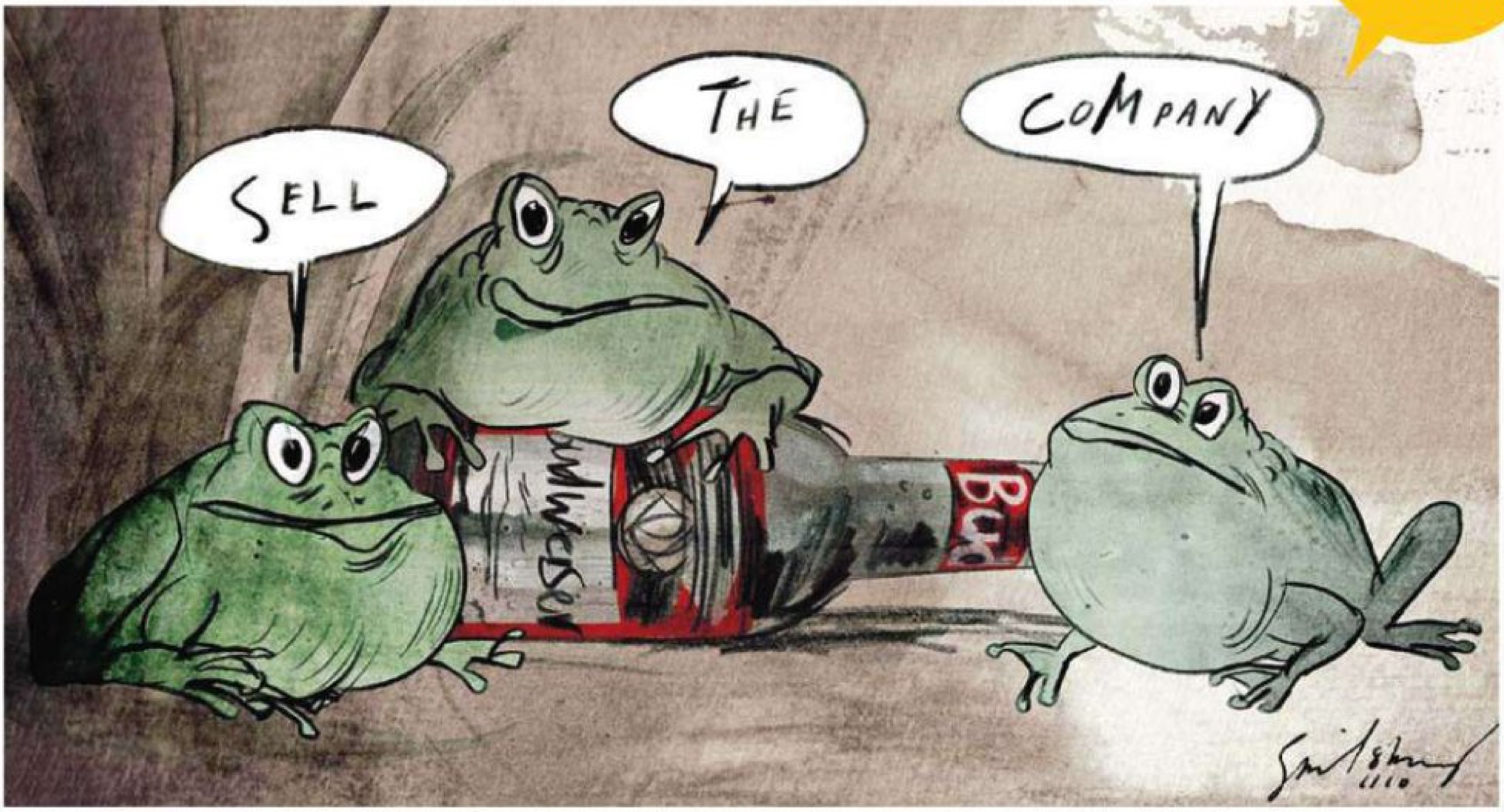
The infinity scarf–also known by several alternate names such as the snood, loop, Moebius, and tube–is this season's ethnic scarf. Slip Topshop's chunky Zig Zag over your head and wrap it around your neck for double the warmth. *$32 at topshop.com*

BOOTS: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

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August Busch IV came up with some memorable ad campaigns, but he wasn't able to hold on to the family brewery



Rhapsody In Brew

Was Anheuser-Busch the victim of globalization, or just a nasty family feud? *By Ian McGugan*

The Busch family, erstwhile owners of the largest brewery in the U.S., used to feed their male heirs five drops of Budweiser within hours of their birth. This ritual suggests the family took its beer very seriously, but it also hints at a unique sense of child-rearing. And while Julie MacIntosh's *Dethroning the King* is ostensibly about the beer business, it spends just as much time unraveling the twisted dynamics of a family in which fathers and sons have battled for generations.

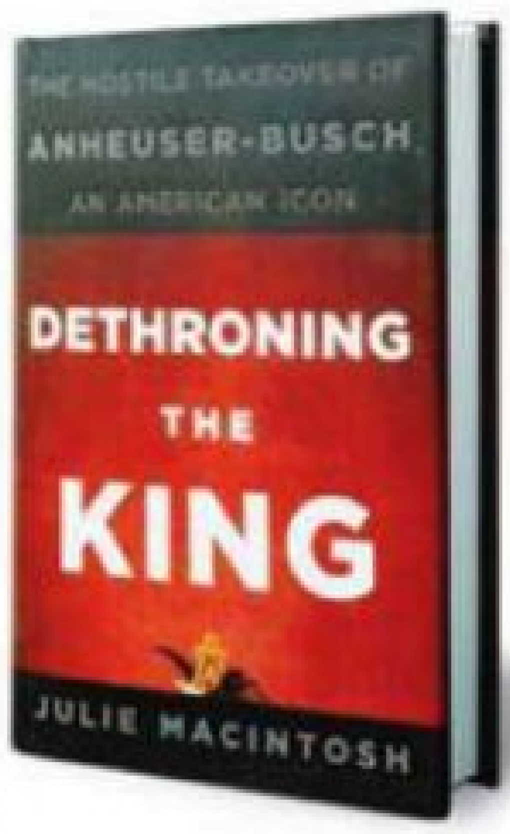
August Busch III—known simply as The Third—seized control of Anheuser-Busch from his father, Gussie, in a boardroom coup in 1975 and ruled the company imperiously for the next 27 years. The Third trusted no one, particularly his own son, August IV—aka The Fourth. Before taking the top job in 2006, The Fourth endured a two-decade-long apprenticeship, much of which, according to MacIntosh, consisted of being belittled by his dad. "They didn't communicate much," she quotes one executive as saying, "unless you call communicating ... getting your ass chewed."

Industrial brewing is driven by economies of scale, and by 2000 the business was dominated by a handful of international conglomerates. By the end of The Third's reign, Anheuser-Busch's independence was in serious jeopardy. Although the company could have jumped ahead of the trend and become a global brewer in the '90s, The Third eschewed the chance to buy Mexican-owned Grupo Modelo outright and preferred to concentrate on the U.S. market. This decision left The Fourth—and the Anheuser-Busch board—with limited options when InBev, the giant Belgian-based brewer, launched a successful takeover bid in 2008.

MacIntosh argues that it was a tragedy for an American such as Budweiser to pass into foreign hands, yet her evidence suggests otherwise. The Busches were hardly vigilant stewards of their shareholders' money, particularly since the family owned only 4 percent of the company. They indulged themselves and their executives with a lavish stream of company-paid $1,000 dinners and

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Dethroning the King: The Hostile Takeover of Anheuser-Busch, an American Icon
By Julie MacIntosh
WILEY
408pp, $27.95



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a fleet of Dassault Falcon corporate jets with a staff of 20 pilots. An avid pilot himself, The Third often flew to work in his helicopter, landing on the rooftop at One Busch Place in St. Louis and trotting a floor down to his office—all to finesse his phobia of elevators. Under The Third, Anheuser-Busch grew to control just over half the U.S. beer market, but it also suffered from his lack of interest in the wider world. "He was not well traveled or well read," says a former colleague. "He was extremely provincial in his viewpoints. Everything was St. Louis and hunting and fishing and the brewery."

The Third's lack of interest in the burgeoning beer markets outside the U.S. border might not have been so problematic if he'd had a more impressive heir waiting to transform the company. The Fourth, however, was no one's idea of CEO material. As a student at the University of Arizona, he flipped his Corvette and crashed in the small hours of the morning, killing a 22-year-old woman in the passenger's seat. The Fourth was found, MacIntosh writes, injured in his townhouse a few hours later. The author explains that he wasn't charged with manslaughter because prosecutors couldn't prove he was driving the car or demonstrate that he was under the influence of alcohol at the time. The Fourth went on to lead a private life that resembled a beer commercial, replete with speedboats, hot tubs, and bikini-clad women.

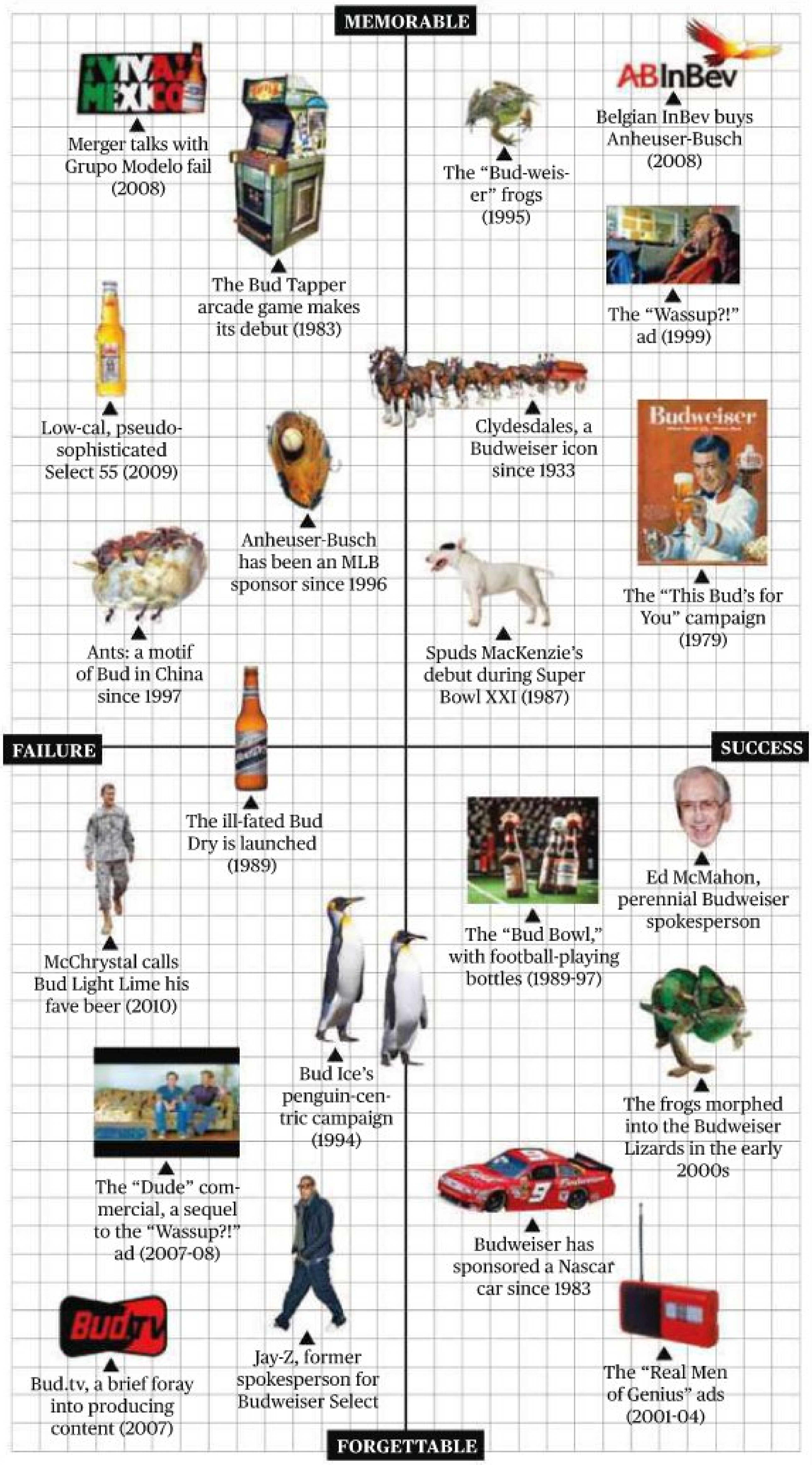
In between partying, he moved into marketing at the family firm. After an initial failure with Bud Dry—and against the resistance of his father, who couldn't fathom how an ad could work without the classic "pour" shot of beer filling a glass—he championed the inexplicably successful campaign in which three frogs croaked out the syllables "Bud-weis-er." The Fourth struck gold again with the blockbuster "Wassup?!" campaign.

When he finally landed the top job, though, U.S. beer sales were slowing and new competition was coming from better-tasting craft brews and globe-spanning companies such as InBev and SABMiller. If Anheuser-Busch, with its only-in-America attitude and luxurious executive lifestyle, epitomized old-style brewing, InBev was the new face of the industry. The Belgian company was run by penny-pinching Brazilians who flew economy and stayed in modest hotels. After on-again, off-again efforts to strike a deal with Grupo Modelo, The Third betrayed his son and, along with the board, agreed to the buyout.

MacIntosh makes much of the loss of an American institution, but even she doesn't seem totally convinced. What lingers after finishing this book isn't any great outrage at the natural course of globalization but rather sadness at how a great company can be undermined by family bickering. B

The King of Buzz

Anheuser-Busch's greatest marketing hits—and biggest business flops



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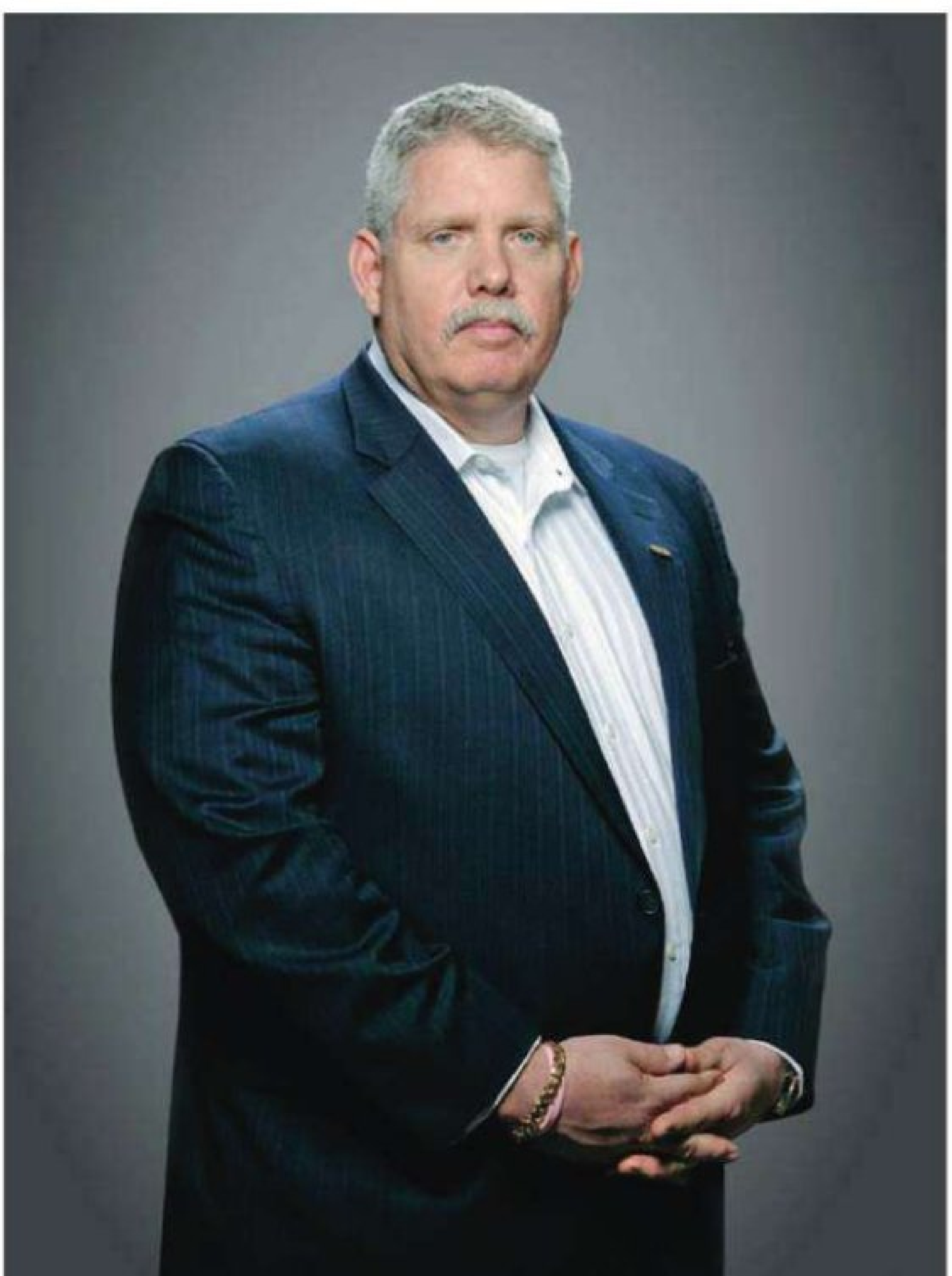
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Etc. Hard Choices

Brian Dunn

"When I encounter someone online who's having a problem, I want to reach out and fix it myself. ... And that's not my job"

The Best Buy chief on getting into social media to learn about his customers and employees—and knowing when to draw the line



A few years ago our chief marketing officer asked me to get into social media. He was ahead of the curve in realizing that a cultural transformation was happening. Best Buy has 180,000 employees, the majority of whom are 24 years old or younger—and so a lot of workers were on MySpace and other sites. I asked him how we could control it, and his answer was: You can't. You engage with it.

Soon, I began talking to employees and customers on Facebook every night at 10 o'clock. It was difficult to get over being self-conscious, since just tweeting about something I saw in a store opened myself up to vulnerability. The hardest part, though, was that once I decided to allocate the time to this, people started weighing in all over the place without context. Then, at one point last year, my Twitter account was hacked and one of my tweets basically said I'd been having a lot of great sex lately.

I felt violated, but it didn't diminish my enthusiasm. I learned a couple lessons along the way. I can engage for 5 or 10 minutes and get a great sense of what's going on in our stores. But when I encounter someone online who's having a problem, I want to reach out and fix it myself. I did that once early on and suddenly I was inundated by others. I'd set myself up as an answer center, and that's not my job. We'll have more than 1.5 billion customer interactions this year, and we have great processes for helping customers. I realized the best thing I can do is point them to the resources. The same goes for my employees.

In my office, I now have a large monitor of all the activity where we're mentioned. I want to know what's out there. I don't have to respond to all of it, but I write everything on my Twitter and Facebook accounts myself—and I'm the one who's posting. I'm responsible for what I say online, and I expect the same of my employees. The only guideline is that they act within our values. You can engage with social media and get comfortable with the messiness of it. We're past the tipping point. You have to be where people are. *—As told to Diane Brady*

DARIN BACK/REDUX

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